

Does Legalization Matter?

*Comparing Compliance with Dispute Settlement under the
GATT and the WTO*

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1. Introduction

In 1995, after the completion of the trade negotiation in the Uruguay Round, the General Agreement on Tariffs and Trade (GATT) was replaced by the World Trade Organization (WTO). The WTO was a continuance of the political trade cooperation begun under GATT in 1947, and with its establishment, the WTO brought about several institutional changes compared to its predecessor GATT. Under the GATT there had been no regular organization, but with the WTO came a firm global trade organization. New subjects, such as services and intellectual property, were being incorporated into the multilateral trading system for the first time. One of the changes that got a lot of attention was the creation of a new dispute settlement system (DSS), designed to solve disputes between the member countries. Compared to GATT, The WTO now had a stronger and more automatic DSS, often referred to as the “jewel in its crown.” The system is unique in international law and institutions, both at present and historically (Jackson 2006: 135). Dispute settlement is by many viewed as the most significant activity of the WTO, and the WTO DSS is commonly viewed as legalized.

1.1 Research question

The topic of this thesis is the effect of the 1995 changes in the dispute settlement procedures on member states’ compliance. My research question is as follows:

Compared to the GATT Dispute Settlement System, have the more legalized Dispute Settlement System of the WTO increased compliance with the rules and rulings of the international trade regime?

This question is of academic relevance and current interest. The current financial situation of the world has shown an increase in the willingness by the governments of the world to use protectionism, the very opposite of the intention behind creating the

WTO. Also, the possibility of cooperation between countries is a topic long studied in political science.

1.2 Literature review

The topic of compliance has been a central issue in the field of political science since the 1960s, and especially in the subfields International Relations and International Law. The changes to a more legal and institutional framework in the WTO brought about great academic interest, both on the general level which concerns state sovereignty and the possibility for international cooperation, and on the more specific level, which concerns the history of GATT and the international trade cooperation seen since the end of World War Two. The more general theoretic debate will be covered later in the chapter 3 of this thesis.

On the specific level, Robert Hudec and John H. Jackson are leading figures. Hudec started writing about international trade law in the 1960, when it was still an “infant field” (Trachtman 2003: 311). The two scholars study the effect of the rules and their consequences in both GATT and WTO. The two do however differ on the impact of legalization on compliance. Jackson saw the GATT DSS as containing “a number of problems” (Jackson 2006: 143), and “insists that the steady shift to more formal rules and processes in GATT (...) culminating with the WTO (...) enhanced compliance with those decisions and hence the effectiveness of not only the dispute resolution but the trade regime as a whole” (Raustiala and Slaughter 2002: 542) Hudec does work that focuses on the politics of dispute settlement and emphasized the success, political flexibility and apparent sustainability of the GATT model and cautioned that the legalized approach might be too cumbersome in various political contexts (Steinberg 2004: 247). He does agree with Jackson that legalization altered compliance, but challenges the view that further legalization will have any impact (Raustiala and Slaughter 2002: 542). He also “maintained that the GATT dispute settlement system was ‘quasi-judicial’ in nature, not entirely diplomatic” (Steger 2002: 482).

The creation of the WTO have produced studies on free trade, the formation of preferential trade agreements and on the impact the organization has on developing countries (Mansfield and Reinhardt 2003; Rose 2004, Bhaqwati 2001). The key question of why, when and how the WTO - and the GATT before it - produces compliance with rulings have been taken up by many scholar interested in compliance and the role of law in international relations (Raustiala and Slaughter 2002: 542). Irwin (2002) calls the WTO DSS “strength of the world trading system”, but also cautions us that even if a country loses a case, the WTO cannot force a change in that country’s law, as a domestic court can:

WTO panels merely determine whether disputed policies conflict with WTO rules and, if they do, recommend that members bring those policies into conformity. The disputing countries must still resolve the matter themselves, often through a negotiated settlement (ibid: 190).

Hughes (2006) views the entire WTO DSS process as “remarkably efficient”(ibid: 195), and when looking at the implementation phase in WTO, claims that the critique of this phase as “slow or ineffective” is unjustified (ibid: 229). She claims that the “compliance record (...) has been extremely high; there are a few famous cases of very slow compliance or non-compliance, which have left the impression that the problem is more widespread than it is in reality” (ibid.).

Palmeter and Alexandrov (2002) study the imposing of restrictions on the trade of another WTO member as a “tool” for imposing compliance (ibid: 646). When looking at a dispute between Canada and Brazil, they find that countermeasures are not appropriate for inducing compliance, and they view countermeasures as a setback for the entire free trade system, and warn against increasing the sanctions available in WTO (ibid: 658-66).

The WTO Appellate Body (AB) has received a lot of attention. According to van den Bossche (2006) when the AB was created, it was expected not to play a prominent role in the WTO DSS, but ended up achieving “great prominence” and is now, “in all

but name, ‘the World Trade Court’” (ibid: 300). This is, among other things, because of its working procedures, which have allowed it to “conduct its work in a fair, efficient, and genuinely judicial manner” (ibid: 306), and because of its consistent behavior towards rule interpretation and its balancing of free trade and other societal values and interests (ibid: 320). Marceau (2006) says the AB has ensured coherence in the WTO (ibid: 347). Steger (2002) claims the AB has contributed to establishing a DSS which is solidly rooted in due process and procedural fairness, which makes the DSS a system which is administered fairly, impartially and in accordance with the rights and obligations of WTO members (ibid: 495). Both Hudec and Jackson share the view that the AB has had a positive effect on compliance (ibid: 493).

Horlick (2002) looks at the effect on compliance and finds problems with the compliance structure of the WTO resolution process. According to him, there is a lack of incentives to swift compliance, because of the possibility of modifying the Panel Report through the AB and the wording “compliance within reasonable period of time” in Article 21.3 in the Dispute Settlement Understanding, extends the period of cost-free non-compliance (ibid: 637-39). The countries are therefore faced with an “irresistibly temptation” to delay compliance (ibid.). Sacerdoti (2006) claims that “implementation has often been complex and has extended over time” (ibid: 54). The cause identified by him, is the degree of domestic action required to implement; implementation is swift when domestic action required is small, slow when legislative branches has to be involved (ibid).

Busch and Reinhardt (2002) studies in a quantitative study if the legalization of the WTO DSS contributed to an increased likelihood of initiated disputes among developed states in the WTO, compared to GATT. They find that the improvements made in 1989 in the GATT, increased the likelihood of initiation, but that the WTO did not, at least until the end of 1998. They therefore conclude, as Hudec did in 1999, that “writers have tended to overstate the difference between the new procedure and its GATT predecessor” (ibid: 464). They also study the effect of the WTO on least developed countries, and find that the result for these countries is “rather

disappointing”, since the countries are now one-third less likely to file a complaint under the WTO than they were under the post 1989 GATT regime (ibid: 467). One reason for this is several new stages of legal activity brought about by the legalization (ibid.).

In 2008, *International Studies Quarterly* published two articles which studied if the changes made from GATT to WTO had changed the behavior of the member states. Kim (2008) looks at the effect that increased procedural cost in the WTO, due to new and complex procedural rules, has on countries’ decisions to initiate dispute settlement. He performs a quantitative study where he compares dispute initiation under the GATT and the WTO, and finds that in the WTO, compared to the GATT, “the probability of member countries requesting consultations - which triggers the formal dispute settlement procedure - is much higher for countries with higher capacity (developed countries) than for countries with lower capacity (developing countries)” (ibid: 679).

Then, in a qualitative small N-study, Zangl (2008) investigates if the United States and the EU have changed their behavior due to the legalization of international trade rules in the WTO. Zangl’s study looks at the diverging views held by realism and neoliberal institutionalism on the effect of international organizations and their structure, and investigates the GATT/WTO DSS in this light. In four cases involving the United States and The EU both as complainant and respondent, he finds that the legalization in the WTO made both parties more compliant (ibid: 846).

My study places itself close to Zangl’s study. I will perform a qualitative small N-study where I use Zangl’s method on a new set of cases to test the robustness of his conclusions. According to Kim (2008) the main deficiency in the literature on GATT/WTO DSS is that “analysis of the consequences of legalization in international institutions is theoretically indeterminate and empirically absent” (ibid: 659). Generally speaking, one can say that there is a consensus that the WTO made the international trade regime more “legalized”. But the effects of such legalization have

not been widely studied empirically. My study will add to the relatively small set of empirical studies in this field.

1.3 Research design

This thesis is a study of a few selected countries' behavior under different international trade regimes. I am going to study if the new DSS in the WTO has had any effect on the compliance of the member countries. The method I use is case study research, which can be defined "as an intensive study of a single unit or a small number of units (the cases)" (Gerring 2007:37). The cases I have chosen are the following:

- 1) The "Japan-Alcohol"-dispute. The matter of the dispute is alcohol-taxes in Japan, which was disputed under both the GATT and the WTO. The respondent is Japan and the complainants are Britain, United States and Canada
- 2) The "US-Softwood lumber"-dispute. The matter of the dispute is duties on imported lumber from Canada, which was disputed under both the GATT and the WTO. The respondent is the United States and the complainant is Canada
- 3) The "EC-Sugar"-dispute. The matter of the dispute is the European Communities' export subsidies on sugar, which was disputed under both the GATT and the WTO. The respondent is the EC and the complainants are Australia and Brazil and Thailand

The key question is now why these cases and what these cases can say about compliance in GATT/WTO?

When studying dispute settlement under GATT and WTO, you have several hundred potential cases that can be used for research. All the disputed cases under GATT/WTO are available on the WTO homepage, WTO.org. Which technique for choosing cases should then be applied? My thesis builds largely upon Zangl's article and the goal of my thesis is to test his findings further. Zangl's article is a study of the

effect of basic systemic characteristics. Andersen (1997) says that when studying basic systemic characteristics, you find cases where the actors are faced with identical problems, the same actors are involved, the actors are organized in the same way and the significance of the problem as viewed by society is the same (ibid: 121). Zangl uses the method of most similar systems design where he keeps the matter of the dispute and the disputing countries constant, thereby controlling for confounding factors (Zangl 2008: 832). His study is also theory testing, as my study will be. Van Evera (1997) says that one case selection criterion that is good for testing theories is to find cases that are good for replicating previous tests. This replication can be exact or inexact, which is more common (“quasi-replication”) (ibid: 87). The three dispute pairs I have chosen are well suited for replicating the test made by Zangl, since the dispute matter is constant. Zangl did however have the same countries involved in all cases, whereas my test will have different countries involved in the different cases. I will discuss the advantages of this in the three case chapters.

There are however several also methodological weaknesses of my approach that one should be aware of.

The first is that this way of selecting cases, gives you the dilemma that if you are to find two similar cases, you have to focus on unsolved or unfinished cases under GATT. The aspect of time is therefore relevant. According to Pruitt (1991), negotiators face a choice among three strategies for moving toward agreement: contending, problem solving, and yielding (ibid: 78). In contending, negotiators pursue their goals by trying to persuade the other party to concede. In problem solving, the goal is to locate an option that is satisfactory for both parties. Yielding involves diminishing one’s goals (ibid.). The interplay of the three strategies is described as follows:

Contending and yielding often alternate in the early stages of negotiation. What presumably happens is that negotiators become discouraged after a period of contending because the other party has not capitulated, and so they lower their goals (namely, yield) to a more realistic level. This allows them to return, with new hope, to

a period of contending. Indirect causation may also help explain why problem solving often emerges toward the end of negotiation. After a period of alternating between contending and yielding, negotiators begin to sense that each party has conceded as far as it can; hence neither yielding nor contending will work any longer. Problem solving remains as the only viable approach (Pruitt 1991: 81).

Thus, after a certain time, the problem solving, or collaboration behavior will appear. A case that started under GATT and went for years, and continued under the WTO, could therefore reach a solution under the WTO simply because of the time aspect. That a country is compliant under WTO is therefore not a certain sign that the WTO is creating that compliance.

A case study is well suited for controlling for this effect, thus providing strong internal validity, because it allows the researcher to peek into the box of causality to locate the intermediate factors lying between some structural causality and its purported effect. The investigation of a single case also allows one to test the causal implications of a theory, thus providing corroborating evidence for a causal argument (Gerring 2007:45).

Second, this way of selecting cases does not make the researcher look at cases that were solved under the GATT. The cases that I will investigate will either be cases that were not solved or partially solved (negotiated settlement) under GATT. This can result in a tendency for this thesis to underestimate mechanisms for dispute settlement under the GATT. According to Jackson (2006) the GATT dispute settlement mechanism was “quite successful” and “worked better than expected and arguably better than those of most international dispute procedures” (ibid: 137). So the GATT clearly worked. This thesis will however look at those cases that were not solved under GATT and went on to the WTO to see if legalization of the DSS could contribute to a solution.

A third problem is that when studying GATT/WTO, there is a selection bias, due to the fact that many cases are never filed at the GATT/WTO. Litigation can be costly;

the potential complainant may not want to draw attention to the dubious legality of policies it, too, employs (Reinhardt & Busch 2002: 460) When it comes to imposing disputable trade measures, potential defendant countries may choose these selectively, dependent on the probability of the target of those measures filing a complaint (Kim 2008: 666). This problem is mostly relevant for quantitative studies and for studies of the WTO's effect on global free trade. In this thesis, this point is important because it narrows down the validity field. This thesis will not have strong external validity, because I will not analyze the complete trade policies of the countries involved, and the small number of cases I have chosen will not have strong validity when it comes to the general phenomenon of compliance in the WTO. This study is therefore a typical example of the trade off between causation a researcher intends to achieve. A cross-case large-N study would have given an estimate of the causal effect of the WTO DSS across a population of cases, but would have been less strong when it comes to illuminating causal mechanisms. This is where my study will have its advantage; using a method suited for finding the causal mechanisms leading to a country's action when involved in WTO litigation.

There is also a methodological problem of measuring compliance. Compliance is in this thesis is to be understood "as a state of conformity or identity between an actor's behavior and a specified rule" (Raustiala & Slaughter 2002: 539). The question of why, when and how the WTO produces a country's possible compliance with a ruling is central to the analytical element of this thesis. A small-N study is well suited for finding the causal mechanisms for compliance. When studying decisional behavior, case study research may offer insight into the intentions, the reasoning capabilities, and the information-processing procedures of the actors involved in a given setting (Gerring 2007: 45). Compliance is also closely related to implementation. Implementation, the process of putting international commitments into practice, is typically a critical step towards compliance. Compliance can occur without implementation, for example if an international commitment matches current policy practice (Raustiala & Slaughter 2002: 539). In this thesis, I will therefore look closely at the actors' implementation policy as a measurement of compliance. Since

compliance can come from a multitude of causes, a small-N case study allows the researcher to isolate the effect of potential control variables. There are several theories about why a country might choose to comply with the ruling of an international organization independent of the institutional design, and these will be covered in chapter 3.

1.4 Disposition

Chapter 1 is an introduction.

Chapter 2 gives an account of the dispute settlement system in the GATT and the changes made in this system with the creation of the WTO.

Chapter 3 provides an account of the views held by realism and neoliberal institutionalism on the effect of legalized dispute settlement systems.

Chapter 4 describes and analyzes the proceedings and results in the “Japan-Alcohol”-case.

Chapter 5 describes and analyzes the proceedings and results in the “US-Softwood lumber”-case.

Chapter 6 describes and analyzes the proceedings and results in the “EC-Sugar”-case.

Chapter 7 discusses the findings in the three case chapters in light of the theory presented in chapter 3.

Chapter 8 concludes.

2. The changes made from GATT to WTO

The General Agreement on Tariffs and Trade (GATT) was established in 1947. GATT was created to facilitate bargaining among participants over the regulation and liberalization of trade policy (Barton et al 2006: 68). 48 years later, the World Trade Organization was established. This establishment brought about several institutional changes compared to its predecessor GATT (Hovi 1996: 331). The GATT regime had in reality no unitary dispute settlement system. The caption “dispute settlement” is not used in the General Agreement from 1947 and no institutions was established for this purpose. Such institutions have instead, based on pragmatic needs and practical experience, gradually emerged (Hovi 1996: 332). Dispute settlement procedures assist in making rules effective, adding an essential measure of predictability and effectiveness to the operation of a rule-oriented system (Croley & Jackson 1996: 193).

The actual dispute procedures in the GATT were based on article XXIII, which specified procedures in cases when parties could not agree after consultation. The article references a contracting party’s right to go to the GATT Contracting Parties for a ruling on a violation. The practice of establishing a panel to assist the Contracting Parties in understanding a case was initially specified not in the articles but in the Annex that describes the customary practice of the GATT. Over time that Annex became more detailed, covering issues such as notification, rules for the selection of panel members, and the role of member governments. By the 1980s, dispute settlement procedures had been formalized in a series of understandings among the Contracting Parties, which specified in great detail the structure, timing, and rules for the resolution of disputes (Barton et al 2006: 68). The fundamental nature of dispute settlement in the GATT was as follows: A case was first vetted in consultations in which the only requirement is that a defendant gives “sympathetic consideration” to the complainant’s grievances (Busch 2000: 428). If, within a set timetable, the case was not resolved to its satisfaction, the complainant could request the formation of a panel, an ad hoc tribunal that interprets the rights and obligations at stake and issues a

ruling. The Contracting Parties had to agree by consensus to establish a panel, to adopt the report of a panel, and to authorize any retaliation if a contracting party maintained rules inconsistent with a panel report. Of course, respondents sometimes blocked the consensus required to move through each stage of the process (Barton et al 2006:68, Busch 2000:428). In 1989, the reform Dispute Settlement Procedures Improvements (DSPI) was ushered. This reform meant that a defendant could no longer threaten to delay or block the formation of a panel (Busch 2000: 426). In other words, the GATT panels prior to 1989 existed on the mercy of the defendant. Prior to the DSPI, due to the ability of a defendant to block the formation of a panel, observers compared GATT to a court that could not deliberate or rule without the permission of the accused (Busch 2000:428). As one observer said, “The GATT has been likened to a court with no bailiff. Once a guilty party stands condemned, there is no bailiff to enforce the sentence. Moreover, the guilty party can avoid sentencing simply by rejecting the verdict” (Reinhardt 2001: 176). In a study, Busch (2000) finds that the IDSP had “no discernable effect on the process of dispute settlement” (ibid: 435).

The fact that panel reports, to become legally binding, had to be adopted in the GATT Council by consensus was viewed as the most important shortcoming of the system. A contracting party that was found to have acted inconsistently with its GATT obligations could thus block the adoption of the unfavourable panel report and thereby frustrate the operation of the dispute settlement system (Van Den Bossche 2006: 291). The GATT Contracting Parties therefore resolved at the launching meeting of the Uruguay Round in 1986 to deal with some of the defects and problems of existing dispute rules (Croley & Jackson 1996: 193).

2.1 The new WTO system

The result of this resolve came about in 1995 when the WTO dispute settlement system was established. As a result of the Uruguay Round negotiations, it was built upon the dispute settlement practices developed under GATT since the late 1940s and was therefore not devised from scratch in the Uruguay Round (Sacerdoti et al 2006:

1). However, the WTO agreement brought about such changes to the GATT system that they induced scholars to use such phrases as “dramatic” (Bello 1996) and “a major turning point” (Panitchpakdi 2006). And where the GATT was an agreement, the WTO now was an organisation (Claes et al 2006:129). Sacerdoti (2006) calls the new WTO dispute settlement system

The mirror of the qualitative leap taken between the GATT and the WTO: away from the partial, incomplete framework, multilateral yet not organized, essentially ‘power based’, and relying only on negotiations, towards a ‘rules-based’ organisation. In the new system, procedural guarantees and an implementation mechanism in order to ensure compliance with the rules represent a necessary complement to the agreed substantive provisions” (ibid: 36).

Upon the creation of the WTO, the U.S. government favoured automatic and binding dispute settlement because most thought such a judicial process would help enforce the set of substantive rules legislated in the Uruguay Round - which the United States favoured (Barton et al 2006: 67). Japan and the EU also favoured the legalization, believing it would benefit, since all three parties viewed themselves more often in compliance with trading rules than its trading partners (ibid:210). The procedures for dispute settlement in the WTO, which are found in annex 2 to the WTO agreement, consists of 27 articles which lay out a detailed description of the procedures and time limits for each step in the dispute settlement. The role of the Dispute Settlement Body is described with these words:

The Dispute Settlement Body (DSB) is hereby established to administer these rules and procedures and, except as otherwise provided in a covered agreement, the consultations and dispute settlement provisions of the covered agreements. Accordingly, The DSB shall have the authority to establish panels, adopt panel and Appellate Body reports, maintain surveillance of implementation of rulings and recommendations, and authorize suspension of concession and other obligations under the covered agreements” (WTO DSU 2008).

Only member states have the right to set off the DSB. Individuals or companies, who feel that their rights are being violated, must therefore convince their government to pursue the case (Hovi 1996: 334). The stages of the dispute settlement are as follows.

a) Consultations

When a complaint is made, the parties are instructed to hold bilateral consultations before the possible establishment of a panel, as article 4, point 3 explains:

If a request for consultations is made pursuant to a covered agreement, the Member to which the request is made shall, unless otherwise mutually agreed, reply to the request within 10 days after the date of its receipt and shall enter into consultations in good faith within a period of no more than 30 days after the date of receipt of the request, with a view to reaching a mutually satisfactory solution. If the Member does not respond within 10 days after the date of receipt of the request, or does not enter into consultations within a period of no more than 30 days, or a period otherwise mutually agreed, after the date of receipt of the request, then the Member that requested the holding of consultations may proceed directly to request the establishment of a panel”(WTO DSU 2008).

One of the fundamental principals of GATT was that a voluntary, bilaterally negotiated solution was preferred over a panel dispute. The same applies to the WTO; the difference is that the WTO holds specific time limits and explicit rules concerning what happens if the deadlines are not upheld (Hovi 1996: 335, Lash 1999:5, Reinhardt 2001:176). It is however important to point to article 3 in the DSU, which states “if a dispute arises, all Members will engage in these procedures in good faith in an effort to resolve the dispute” (WTO DSU 2008). Legalization in the WTO is thus explicitly tied to a requirement that member states resolve their trade disputes through the DSS, not through unilateral determinations and responses. This provision is “aimed directly at the coercive tactics of the United States under section 301” (Abbott & Snidal 2000: 431).

b) The establishment of a panel and the panel process

The establishment of a panel happens if

the complaining party so requests, a panel shall be established at the latest at the DSB meeting following that at which the request first appears as an item on the DSB's agenda, unless at that meeting the DSB decides by consensus not to establish a panel”(WTO DSU 2008).

This request shall be made in writing and shall indicate whether consultations were held, identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly (ibid.). This gives each member country the right to get the request of a panel granted, which is a change from the GATT system, where requests like this had to be approved by consensus in the GATT Council and thus could be blocked by any member (Jackson 2006: 153). The members of the panel shall be selected with a view to ensuring the independence of the members, a sufficiently diverse background and a wide spectrum of experience, and citizens of members whose governments are parties to the dispute or third parties as defined in paragraph 2 of Article 10 shall not serve on a panel concerned with that dispute, unless the parties to the dispute agree otherwise (WTO DSU 2008).

Next, the dispute panel will share with the parties an interim report containing its findings and conclusions. The parties will have one week to comment on this report. The review period follows, which must not exceed two weeks. During that time, the panel may hold additional meetings with the disputing States. Then it will prepare a final report and submit it to the parties. Three weeks later, the final report will be circulated to all WTO members. Under DSU Article 16.4, the report will become a DSB ruling or recommendation within 60 days unless a consensus of the DSB rejects it or a party to the dispute formally notifies the DSB of its decision to appeal to the Appellate Body. Either party has the right to appeal (Sarhan 2005; WTO DSU 2008). According to Jackson (2006) in this “perhaps the most critical stage of the dispute process”, the adoption stage, there has been a “dramatic” change compared to GATT (ibid: 156). Under GATT the “Council” used a consensus procedure for adoption, which meant that any member could block it. Under the WTO the final report will be

adopted unless there is a consensus against it, which means virtual automatic adoption (ibid.).

c) The appellate process

Should one of the parties decide to appeal, the case is then handed over to the Appellate Body (AB). Even a “winner” can appeal, and this has sometimes been the case when the language of the panel report displeases even a winner, such as using grounds for a determination “that has long-range implications which bother the appealing disputant” (Jackson 2006: 157). The AB may “uphold, modify or reverse” legal findings of a panel, which has been taken to mean that there is no “remand” power (ibid: 158). When the AB’s final report is completed, it is sent to the DSB for adoption, and like the process for panel report adoption, the procedure is automatic adoption with the reverse consensus. When the AB report is adopted, the ruling also adopts the panel report insofar as it is unchanged by the appeal report. (ibid.). According to Hovi (1996: 338), since the new WTO system automatically adopts the report, unless there is a consensus to reject it, there is a danger that reports can be adopted on failing legal grounds. The AB contributes to the reduction of this risk, and the appeal-feature was determined at the Uruguay Round to be necessary partly because of the automatic adoption of panel reports with no blocking permitted (Jackson 2006: 156).

d) The implementation and compliance requirements

The case then moves on to the implementation stage. The DSU will require a respondent country found to have violated WTO agreements to indicate what actions it plans to take to implement the recommendations. If immediate implementation is not practical, DSU Article 21 calls for implementation within a reasonable period of time. The length of this period will normally be proposed by the offending country and then approved by the DSB (Sarhan 2005; WTO DSU 2008).

There are two remedies available to a complaining State when the respondent State has failed to implement recommendations by the DSB or the Appellate Body within the reasonable period, as determined above. The first is compensation and the second is a "suspension of concessions" authorized in Article 22.2 of the DSU:

If the Member concerned fails to bring the measure found to be inconsistent with a covered agreement into compliance therewith or otherwise comply with the recommendations and rulings within the reasonable period of time determined pursuant to paragraph 3 of Article 21, such Member shall, if so requested, and no later than the expiry of the reasonable period of time, enter into negotiations with any party having invoked the dispute settlement procedures, with a view to developing mutually acceptable compensation.

If the parties do not agree about a compensation agreement within 20 days of the deadline, the complainant can ask for permission to retaliate. A consensus is needed to refuse such permission. Retaliations shall primarily be within the sector where the violation occurred (Hovi 1996: 338). The DSU is explicitly stating that the various compensatory or "retaliation" measures are only temporary, pending full compliance (Jackson 2006: 159). The GATT had some possibilities for reciprocal and other measure to "encourage" compliance, but these were relatively weak. The WTO has on its side developed an elaborate set of possibilities for reacting to measures by WTO members which harm others (ibid: 196). The Dispute Settlement Body monitors how adopted rulings are implemented. Any outstanding case remains on its agenda until the issue is resolved.

2.2 Main differences

Obstructing the dispute settlement process requires the consensus of the WTO members. Consensus is needed to reject a request to establish a dispute panel; to reject a panel report; to reject a request to appeal; to reject the Appellate Body's report; and to reject a request for suspension of concessions. Consensus can rarely (if at all) be obtained as there normally is at least one party who has an interest in not rejecting one

of the above (either the complaining State or the offending State) (Sarhan 2005; Barton et al 2006: 71). A “Consensus- minus-two”- rule was suggested by the US at the early stages of the Uruguay-Round. This was not chosen. This rule would have entailed a possibility that a losing country might persuade another country not to adopt the report, alternatively, another country with an interest in the case, and could help block the report (Hovi 1996: 337). Instead, the full consensus line was chosen. This is often referred to as “negative consensus” (Steinberg 2004:247). Compared to GATT, the WTO system has turned the consensus rule up-side down, resulting in “almost automatic adoption” of a panel report (Jackson 2006: 144). It clarifies that all parts of the Uruguay Round legal text relevant to the matter in issue and argued by the parties can be considered in a particular dispute case (ibid.). Time limits have been made clearer and the right of a complaining government to have a panel process initiated has been clarified. The creation of a judicial body to which nations can appeal panel reports, The Appellate Body, is also a significant change. This Body is a substitution for some of the former procedures of the GATT Council approval of a panel report, and the reversed consensus also applies here, with “the ultimate result that the appellate report will come into force as a matter of international law in virtually every case” (ibid.).

The international trade regime has with the creation of the WTO been legalized (Steinberg 2004: 247, Jackson 2006: 159, Goldstein et al 2000:389). Legalization refers to “a particular set of characteristics that institutions may (or may not) possess, and these characteristics are defined along three dimensions: obligation, precision, and delegation” (Abbot et al 2000: 401). Obligation means that states or other actors are bound by a rule or commitment or by a set of rules or commitments. Specifically, it means that they are legally bound by a rule or commitment in the sense that their behaviour there under is subject to scrutiny under the general rules, procedures, and discourse of international law, and often of domestic law as well. Precision means that rules unambiguously define the conduct they require, authorize, or proscribe. Delegation means that third parties have been granted authority to implement,

interpret and apply the rules; to resolve disputes; and (possibly) to make further rules. These dimensions are pictured in figure 1(ibid.):

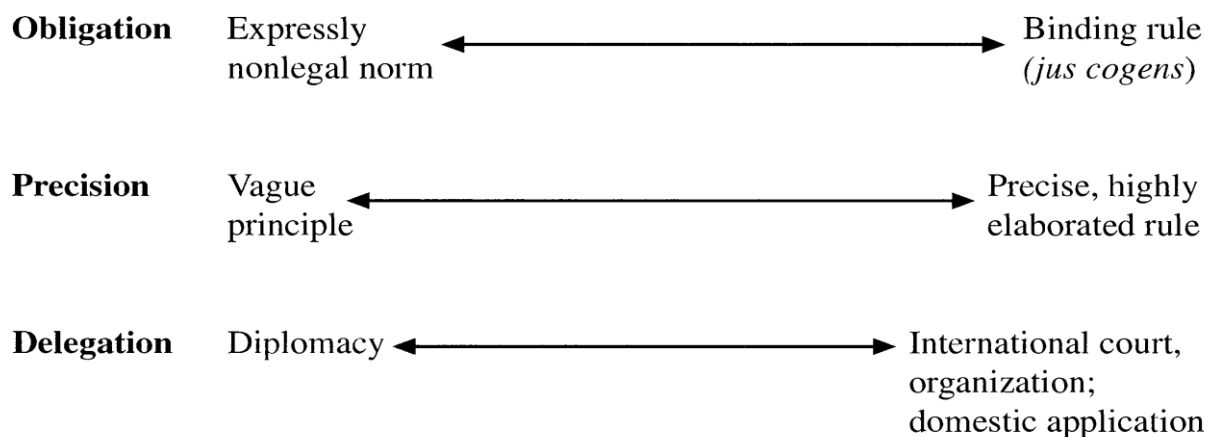


Figure 1.

The WTO is by Abbott et al (ibid.) said to administer a remarkably detailed set of legally binding international agreements and to operate a dispute settlement mechanism with significant authority to interpret and apply those agreements in the course of resolving particular disputes (ibid: 405). It therefore has a high score on all three dimensions. According to Kahler (2000), legalization contains an implicit promise: compared to institutions that do not share the characteristics of obligation, precision, and delegation, greater cooperative gains will be reaped by resolving collective action problems more efficiently (ibid: 673). In the following chapter I will discuss different theoretical assumptions on the effect of this legalization.

3. Legalization, Realism and Neoliberal Institutionalism

The topic of this thesis is the dispute settlement systems in the GATT and the WTO and how the new design of these procedures in the WTO might have affected member countries' compliance with the rules and rulings of the WTO. A major problem concerning compliance in international relations is the fact that "at the international level, there is no institution which can be relied upon to compel the signatories to comply with the agreement" (Hovi 1998: 77). According to Waltz, the international system is a self-help system (Waltz 1979), and a result of this is that international agreements are viable only to the extent that the parties voluntarily comply with their obligations (Hovi 1998: 77). There are different theoretical approaches to the likelihood of successful cooperation and the expected effect of an international organisation, and there has also been written extensively about the best way to design an organisation so as to ensure compliance.

Is it possible to make sovereign states more compliant by changing the legal design of an international institution? Or will states follow the institution's rulings only when it is in their own self – interest? The theories I am going to base my hypotheses on are realism and Neoliberal Institutionalism. In the following pages, I will explain the expected effect of increased legalization held by these two theories.

3.1 Realism and international institutions

Despite of the shared assumptions, realists have responded rather critically to the institutional theory. Two of the most prominent critics are Joseph Grieco and John Mearsheimer. According to Grieco (1988: 488), realism encompasses five propositions: (1) States are the major actors in world affairs, (2) The international environment severely penalizes states if they fail to protect their vital interests or if they pursue objectives beyond their means, (3) International anarchy is the principal force shaping the motives and actions of states, (4) States in anarchy are preoccupied with power and security, are predisposed towards conflict and competition and often

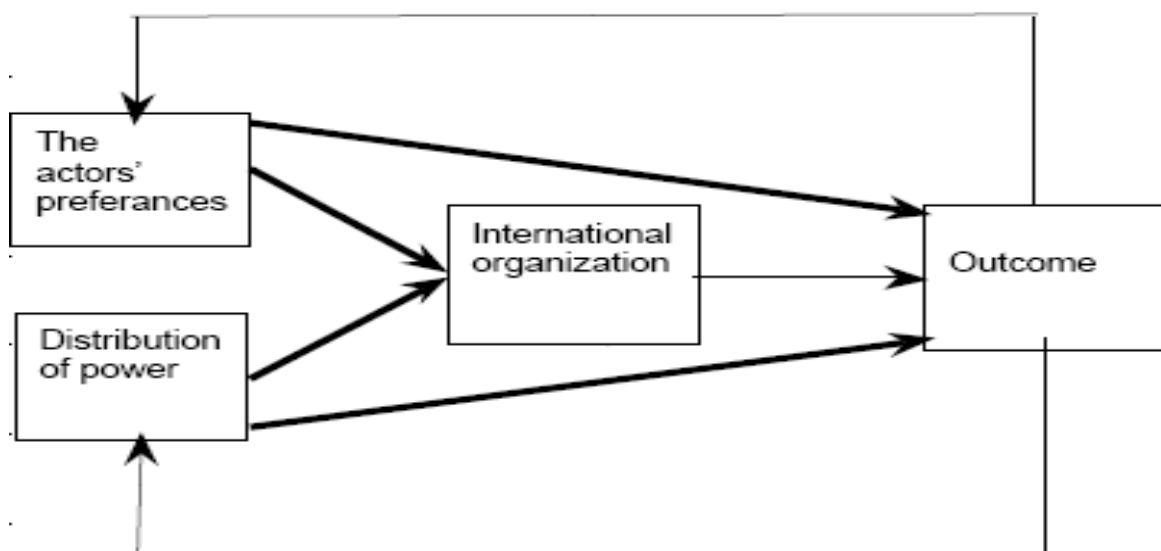
fail to cooperate even in the face of common interest, and (5) International institutions affect the prospects for cooperation only marginally (ibid).

Realists claim that institutions are basically a reflection of the distribution of power in the world. They are based on the self interested calculations of great powers, and they have no independent effect on state behavior (Mearsheimer 1995: 7) The realist explanation of the great amount of time and attention spent on constructing legalized institutions, is that legal rules emanate from dominant powers and represent their interest. Legal rules that “work” bind the weaker members of the system; enforcement of those rules ultimately depends on willingness by stronger powers to bear the cost of enforcing legalization (Goldstein et al: 391). Realists believe that the design of the institution and the level of legalism in an organization have little or no impact on a state’s behaviour, “except, perhaps, when a legalized regime is imposed by a more powerful state on the less powerful” (Kahler 2000:672).

A realist view on international trade is what Gilpin (1987) calls economic nationalism. This view is critical of the liberal doctrine of free trade because the doctrine is politically naïve and fails to appreciate the extent to which the terms of trade and the rules governing trade are determined by the exercise of power (ibid: 190).

The realist view can be pictured as shown in figure 2. The thickness of the arrows indicates how strong the relationships between the parts are assumed to be.

Figure 2: (Hovi & Underdal 2003: 181)



Realists do not claim that cooperation will not occur, but that it is difficult to achieve and particularly to sustain. There are two reasons for this, namely (1) relative – gains considerations and (2) concerns about cheating (Mearsheimer 1995: 12).

1. Relative – gains considerations.

Kenneth Waltz suggests that the first concern of states is not to maximize power but to maintain their position in the system (Waltz 1979: 126). This means that states seek to prevent increases in others' relative capabilities and that they assess their performance in any relationship in terms of the performance of others (Grieco 1988: 499). Grieco suggests that states are positional, not atomistic in character and that *state positionality may constrain the willingness of states to cooperate*. A state will therefore decline to join, will leave, or will sharply limit its commitment to a cooperative arrangement if it believes that partners are achieving, or are likely to achieve, relatively greater gains (ibid.). An important reason for this consideration is the uncertainty of future intentions of other states and one therefore pays close attention to how cooperation might affect relative capabilities in the future. The uncertainty comes from the inability of states to predict or readily control the future leadership or interests of partners.

Grieco contrasts the realist view with the neoliberal view and claims that

while neoliberal institutional theory assumes that state utility functions are independent of one another and that states are indifferent to the payoffs of others, realist theory argues that state utility functions are at least partially interdependent and that one state's utility can affect another's (Grieco 1988: 501).

2. Concerns about cheating.

Concerns about cheating are often studied using a “prisoner's dilemma”-model. In this model two states can either cheat or cooperate with the other. Each side wants to maximize its own gain, but does not care about the size of the other's gain; each side cares about the other side only insofar as the other's side chosen strategy affects its own prospects for maximizing gain (Mearsheimer 1995: 17). The ideal outcome for a

state is therefore to “sucker” the other side into thinking it is going to cooperate, and then cheat. But since both sides understand this logic, and both sides “will therefore try to cheat the other and both side will therefore lead mutual cheating which leads to the worst possible outcome”¹ (ibid.). Mearsheimer claims that since neoliberals argue that cheating is the only obstacle to cooperation, they claim that their theory applies to the economic but not the military realm. However, he says, when you take the relative gains consideration into the equation, concerns only with overcoming the problems with cheating become impossible since military might is highly connected with economic might, i.e. the relative size a state’s economy has profound consequences for its standing in the international balance of military power (Mearsheimer 1995: 20). The relative gains consideration and concerns about cheating are therefore closely intertwined.

Krasner (1983, in Steinberg & Zasloff 2006: 74) developed a structural realist view on international law and international organisations: state behaviour and associated international outcomes may appear to be shaped by international law, but because international law mirrors the interests of powerful states, “international is merely an epiphenomenon of underlying power” (ibid.). Goldsmith and Posner (2005) developed this view further and claimed that state representatives only use the language of international law as a rhetorical device to justify their behaviour, which is in actual fact only motivated by the desire to serve their national interest.

In summary, the realist views about the effects of legalization are:

- Legalization will not cause Powerful to change their behavior.
- Weaker states will choose to comply with the rulings of the WTO when faced with a stronger opponent.

A “modern reprise” (Abbott & Snidal 2000: 422) of the realist view on compliance is the enforcement school, which claims that studies that demonstrate high levels of

¹ This is a mistake on Mearsheimers behalf. The result of the prisoner’s dilemma is the second worst possible outcome.

compliance may suffer from a selection bias: Governments will only negotiate agreements and establish institutional rules that they fully intend to follow in any case (Downs et al 1996: 673). A high level of compliance with the WTO rulings could therefore result from the fact that legalization has not altered government behavior “in the slightest” (Kahler 2000: 673).

In summary, the enforcement schools views about the effect of the legalization are:

- In areas where a great change in domestic policy is needed, legalization will not affect countries behavior.
- Change in a nation’s trade policy as a result of a WTO dispute, can come from an already established intention of change prior to the dispute.

3.2 Neoliberal Institutionalism and legalization

Neoliberals answer the question “can organizations change the behaviour of states?” in the affirmative. In his book “International Institutions and State Power”, Robert Keohane gives the following account of neoliberal institutionalism (NLI):

The principal thesis (...) is that variations in the institutionalization of world politics exert significant impacts on the behaviour of governments. In particular, patterns of cooperation and discord can be understood only in the context of the institutions that help define the meaning and importance of state action (Keohane 1989: 2).

This is not to say, according to Keohane, that states are always highly constrained by international institutions, nor that states ignore the effect of their actions on the wealth and power of other states (ibid.). The central argument for Keohane is that state actions depend to a considerable degree on prevailing institutional arrangements. Such arrangements affect

- the flow of information and opportunities to negotiate;

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- the ability of governments to monitor others' compliance and to implement their own commitments – hence the ability to make credible commitments in the first place; and
 - prevailing expectations about the solidity of international agreements(ibid.).

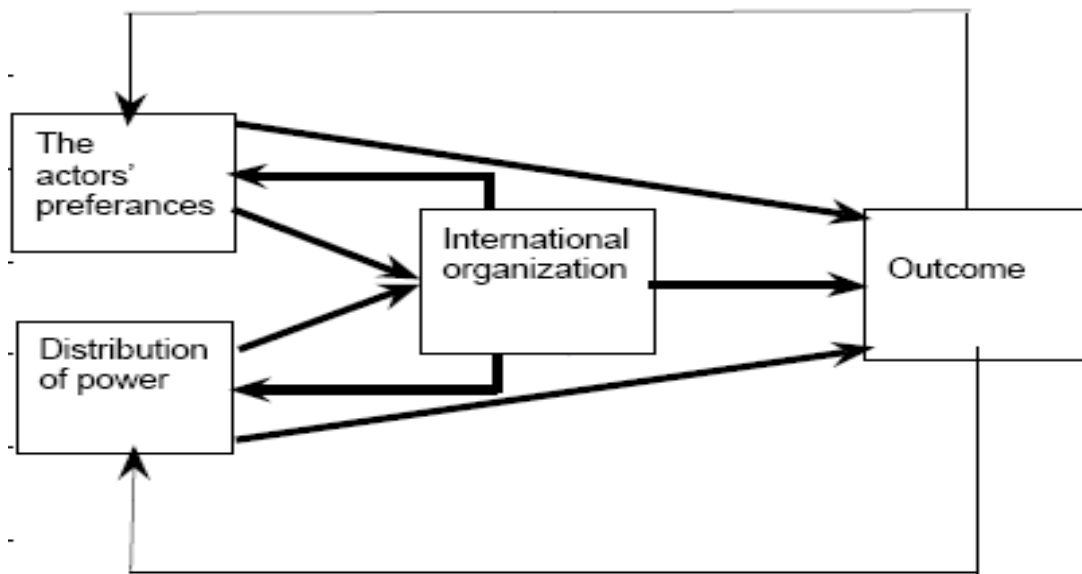
Keohane further points out that in order for the NLI perspective to be relevant, the following two conditions must pertain: 1) Actors must have some mutual interests and potentially gain from cooperation, 2) Variations in the degree of institutionalization must be substantial, because if the institutions of world politics were fixed, it would be pointless to emphasize institutional variations to account for variations in state behaviour (ibid.).

In the context of the WTO, both of these two conditions are fulfilled. In economic terms, the benefits from trade accrue to consumers through greater choice and lower prices and to producers of exportable goods that find expanded markets. Economic theory suggests that trade openness is, in general, welfare enhancing by bringing better jobs, new products and higher levels of aggregate wealth (Barton et al 2006: 29-30). However, trade is highly politicized, and politicians who want to keep open markets must assure that those who will benefit from openness have an avenue for political participation. The change in the United States in 1947 when entering GATT, from bilateral to multilateral trade bargaining, increased the flexibility to conclude trade deals, thereby affecting U.S. behaviour (ibid: 32).

Where NLI differ from the realist arguments is not on its assumptions about actors, but rather on the exemplary problem in the international system: are states primarily concerned with market failure or with relative gains and distributional conflicts, and could issues be resolved through the voluntary acceptance of institutions that leave all actors better off, or would coercion and power be more important for determining outcomes? (Keohane et al 1998: 663). NLI focuses, naturally, on the role of market failure and voluntary cooperation. The key terms for NLI are preferences, information, strategies and common knowledge (ibid: 678).

The NLI view on the relationship between states and organisation can be pictured as shown in figure 3. The thickness of arrows indicates the relationship, as in the realist model above:

Figure 3 (Hovi & Underdal 2003: 183):



When explaining why states choose to create legalized dispute settlement systems, proponents of NLI point to a number of reasons. Abbott and Snidal (2000) operates with a “hard” and a “soft” version of legalization. Since WTO is within the confines of “hard law”, I will focus on the principles for this version:

- 1) Legalization increases the credibility of the parties’ commitments, constraining self serving auto-interpretation via the precision of individual commitments, the granting of interpretive authority to courts, lining out accepted modes of legal discourse and coherence between individual commitments and broader legal principles. The cost of reneging is also increased. With a hard law commitment, the reputational effect of violation can be generalized to all agreements subject to international law, which provides the very foundations for statehood (ibid: 427).

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- 2) Legalization enhances the capacity for enforcement. Legal review allows allegations and defenses to be tested under accepted standards and procedures, thereby increasing the reputational cost if a violation is found (ibid).
 - 3) Legalization entails fixed consequences for legal violations. The “countermeasures” in the WTO legitimizes retaliation and clarify its intent, thereby reducing the costs and risk of self - help (ibid).
 - 4) By entailing a specific form of discourse, requiring justification and persuasion in terms of applicable rules and pertinent fact, legalization largely disqualifies arguments based solely on interests and preferences (ibid:429). Legalization is an effective device for organizing ongoing interactions, because it implies that most disputes and questions of interpretation should be addressed through specialized procedures. If negotiated solutions are permitted, as in WTO, this means that states bargain “in the shadow” of anticipated legal decisions (ibid: 431).
 - 5) On the domestic level, executive officials should look to hard international law when they want to change the views of other domestic agencies or political groups with diverging views. The same applies when executive officials have preferences that differ significantly from those of competing power centers. This perspective makes domestic politics and constitutional law significant explanatory variables (ibid: 430).
 - 6) When legal rules are in effect, unauthorized coercive behavior is generally seen as illegitimate (ibid: 431).

NLIs do however state that these principles “may be ignored in practice, especially by powerful states” (ibid.). They do nonetheless say that institutions can matter and that the level of legalism can affect a nation’s behaviour and level of compliance². The “negative consensus”-rule in the WTO, resulting in almost automatic adoption, is particularly relevant when it comes to constraining the above mentioned “self serving auto interpretation” and “arguments based solely on interests and preferences”.

In summary, neoliberal institutionalism suggests that the legalization of the WTO will increase compliance because increasing legalization entails:

- Increasing reputational costs and credibility commitment.
- Improves governments' ability to fend off domestic actors with diverging views.
- The "negative consensus"-rule reduces the potential role of self-interest.
- Clearer rules and regulations make it easier to monitor others compliance.

My ambition with this study is not to prove one of the two theories "right" or "wrong". The area of research and number of cases are too small for this to be done. I will however be able to see which of the theories outlined in this chapter best explains my findings in the cases I investigate. I will be able to see if the legalization of the WTO can contribute to level the international power-based playing field, which realists assume it will not, and if legalization can contribute to increased cooperation in line with the neoliberal assumption. In the following three chapters I will study the effect of the legalization of the WTO DSS in the three dispute pairs explained in chapter 1.

² It is important to say that these differences between realism and NLI are ideal types, and that the disagreement not necessarily is as big as pictured here. See Jervis 1999.

4. The “Japan Alcohol”-dispute

The two disputes in this chapter deals with Japan’s taxing of domestic and foreign alcohol products. The disputes I consider in this chapter are:

- A) The EEC versus JAPAN in 1987 under the GATT system. The dispute is “Japan - customs duties, taxes and labeling practices on imported wines and alcoholic beverages”. This will be referred to as “The GATT-alcohol”-dispute.
- B) The EU, Canada and USA versus Japan in 1996 under the WTO system. The dispute is “Japan - Taxes on alcoholic beverages”. This will be referred to as “The WTO-Alcohol”-dispute.

Japan was as mentioned one of the countries pressing for legalization of the WTO DSS under the Uruguay Round, and the complaining parts in these two cases are, together with Japan, referred to as the “Quad”; Canada, United States and the EU. In 2000, the “Quad’s” combined share of the total GDP of all WTO members was roughly 81 % (Barton et al 2006: 13). This dispute pair therefore allows to test if the countries that pressed for the legalized system are willing to follow the legalized procedure and to abide by its rules. Also, in his research design, Zangl makes the assumption that if the legalization can affect the behavior of the United States, it is likely it will have “similar effects on the behavior of less powerful states as well”(ibid: 832). This case pair allows this assumption to be tested on Japan.

4.1 “The GATT Alcohol”-dispute.

In 1984, according to the 18th General report of the Activities of the EU, the communities’ trade deficit with Japan leveled off at around 13,000 million European currency units (ECU) as a result of a moderate overall increase in Japanese exports to the EC and a greater increase in EC exports to Japan (Keesing 1987: 35384). The EU attempted repeatedly during 1984-87 to encourage the Japanese government to open up its own market to EC goods, and on April 2, 1984, the EU commission submitted

to the Japanese authorities a new list of measures needed to open up the Japanese market, but by mid- 1985 both the EC Council of Foreign ministers and the European Council of EC heads of state and government criticized the Japanese authorities for their “absence of reaction” to such demands (ibid). Japan disagreed and said that the EU ignored the “solid results” achieved in the areas of establishing common standards, certification and product labeling and concerning the issue of government procurement (ibid). The EU Commission was not satisfied, and in October 1986 a commission paper on the opening up of the Japanese market urged a speedy removal of Japanese trade barriers on various products, and a specific complaint centered on a tax system in Japan which imposed a disproportionately high tax on the sale of European alcoholic beverages, particularly Scotch whisky and French cognac (ibid).

The dispute was brought to GATT already on July 22 1986, when the European Communities requested consultations with Japan under article XXII:1 on Japanese customs duties, taxes and labeling practices on imported wines and alcoholic beverages. In a further communication dated 31 October 1986, the European Communities stated that consultations between the EEC and Japan had not resulted in a satisfactory settlement and that the community wished to refer the matter to the GATT Contracting Parties in accordance with article XXIII:2 (GATT L/6216: 1). At the Council meeting on 5-6 of November 1986 The EU Community requested the establishment of a panel, but Japan replied that an examination under article XXIII:2 would not help to produce a practical solution to the politically and difficult process of tax reform in Japan and could not accept the establishment of a panel (ibid). At the council meeting on 21 November 1986, the community again requested the establishment of a panel. Japan considered that consultations had not been exhausted and that recourse to Article XXIII:2 and to the “urgency procedure” was inappropriate pending the outcome of the tax reform examination by the Japanese Government in December 1986 (ibid.)

On December 19 1986, the Japanese Ministry of Finance presented to the EU Commission proposals on reforming the Japanese taxation system for wines and

spirits. These were rejected as inadequate by the Commission, which claimed that “whiskies and brandies of inferior grades produced in Japan will remain subject to much lower taxes than those applicable to imported products”. Tariff reductions of some 30 per cent were described as “a step in the right direction”, but the Commission declared that it would still pursue a test case alleging Japan’s failure to effect satisfactory adjustment of its policies under article XXIII of the GATT (Keesing 1987: 35384). At the Council meeting on 4 February 1987, the Council agreed to establish a panel “to examine, in the light of the relevant GATT provisions, the matter referred to the Contracting Parties by the European Communities in document L/6078 and to make such findings as will assist the Contracting Parties in making the recommendations giving the rulings provided for in Article XXIII:2” (GATT L/6216: 1).

4.1.1 Arguments by the parties

The EC requested the panel find that the Japanese system of taxation was

- a) Discriminatory with regard to imported alcoholic beverages in contravention of the provisions of Article III:1 and 2. The discrimination was due to 1) the absence of uniformity in the Japanese system of taxing alcoholic beverages, which was characterized by a differing tax-assessment basis depending on established product-categories and which amounted to penalizing imported products *viv-a-vis* domestic producers, 2) the application of surprisingly different rates for similar products, based on a classification which resulted in a distinct heavier levy on imported products than on domestic products, 3) practices of the Japanese administration aimed at subjecting imported products to the highest taxation and 4) the aggravating impact of extremely high customs duties (*ibid*: 3-4).
- b) Wines and alcoholic beverages imported into Japan did not enjoy adequate protection as regards origin making. The Community considered that Japan had not fulfilled its obligations, with regard to Article IX:6, in preventing

trade names of wines and alcoholic beverages originating in the community from being used in such manner as to misinterpret the true origin of the products (ibid).

Japan, on their side, requested the panel to find that Japan's liquor tax did not discriminate between domestic and imported alcoholic beverages and was not applied in such a way as to afford protection to domestic production inconsistent with article III:1 and 2. Japan had also met its obligations under Article IX:6 by taking necessary measures to prevent misrepresentation of the true origin of alcoholic beverages which might be caused by labeling (ibid:10).

4.1.2. Findings and conclusions by the panel

Argentina, Canada, Finland, The United States and Yugoslavia gave submissions as interested third parties and all, in a more or less direct language, supported the EC in their claims against Japan (ibid: 19). The international pressure on Japan was thus increased. The GATT- panel noted that the dispute was due to diverging views of the European Communities and Japan on the interpretation of GATT Article III:1 and 2, which reads:

1. *The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.*
2. *The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic*

products in a manner contrary to the principles set forth in paragraph 1 (GATT 1947).

The Contracting Parties had never developed a general definition of the term “like products” in Article III:2, and drafting history confirms that the article was designed with “the intention that internal taxes on goods should not be used as a means of protection” (GATT L/6216: 23-4). Past decisions on this question were made on a case-by-case basis after examining relevant factors (ibid.). The panel decided to agree with the interpretation laid forward by the EC. The panel concluded, first, that Japan was not in violation of Article IX:6, but with regards to Article III:2, it found that “whiskies, brandies, other distilled spirits, liqueurs and sparkling wines imported into Japan were subject to discriminatory or protective taxes contrary to the article, and the panel therefore suggested that the Contracting Parties should recommend that Japan brought its taxes on the mentioned alcohol products in conformity with its obligation under the General Agreement (ibid:32; The Boston Globe 1987).

4.1.3. Actions taken by Japan

Already before the GATT recommendation, Japanese business leaders urged their government to cut taxes on imported alcohol, and stressed that the EC regarded the issue as a symbol of the obstacles to penetration of the Japanese market, and that imported alcohol had too high custom duties (Chicago Sun-Times 1987). Thus, the Japanese Government was under pressure from both foreign and domestic actors. And the Japanese did indeed something with their taxes on imported alcohol product. In 1988, the Japanese prime minister launched a tax reform package that was welcomed among Scottish whisky producers. Previously, Scottish whisky was taxed higher than Japanese, but after the reform the tax discrimination would be abolished and importers would compete on equal terms (Economist 1988) Whisky would however be taxed higher than neutral brown spirit, and there was the possibility that Japanese firms move their whisky to this low-taxed category, and then the importers again would be competing against brands that have a head start from the tax system. The

importers, however, reckoned that the tax authorities in the Ministry of Finance would stop its liberalization being so easily foiled (ibid).

On 2 February 1989, the Government of Japan informed the Contracting Parties that the ad valorem tax and the grading system had been abolished, resulting in a single rate for all grades of whisky/brandies, and that the changes had been considerably reduced by decreasing the specific tax rate for whisky/brandies and raising that on shochu³(WTO Panel Report DS8/10/11: 12). Japan said that these changes were made with a view to implementing the recommendations adopted by the GATT Council mentioned.

The EC did seem to be satisfied with the Japanese solution. In august 1990, the EC delegate to the GATT told the council meeting that Japan had achieved “impressive results” in cutting restrictions on imports of wine and alcohol. The protections against other merchandise, though, were too high (New York Times 1990). The US delegate expressed the same sentiments and said that despite some progress, much remained to be done (ibid). The steps taken by Japan were seen as a step in the right direction by its trading partners, but clearly not enough.

According to an accord between Japan, US, EC and Canada unveiled in July 1993, tariffs would be scrapped entirely on pharmaceuticals, construction equipment, medical equipment, beer, and most furniture, farm equipment and **alcohol** (Chicago Sun-Times 1993). Japan did however not deliver, and the satisfaction regarding the Japanese policy towards alcohol imports vanished. In February 1994, the International Herald Tribune (1994) reported that “The United States and Europe had been pressing Japan to make bigger cuts in its tariffs on wood, white alcohols such as gin and vodka, and on leather and footwear than it had promised in December”(ibid.). "That hasn't happened, and at this point it's hard to be optimistic about it," John Schmidt, the chief U.S. negotiator for the Uruguay Round, said (ibid). In May 1994, the Liquor Tax Law was further amended to raise tax rates on shochu and on spirits, while

³ A potato-based spirit (Economist 1995)

whisky rates remained unchanged (WTO Panel Report DS8/10/11:13). However, this was not enough to settle the “alcoholic tension” between the east and the west, and one and a half years later the parties engaged in a new dispute. And this time, the dispute was to be settled under a mutually agreed legalized system.

4.2 “The WTO Alcohol”-dispute.

Since the GATT ruling in 1987, Japan had made two reforms on its alcohol tax system, and claimed that their taxes now conformed to WTO rules. The EC, US and Canada, thought otherwise (Economist 1995). Also, on the domestic level, “all interested parties in Japan had already noted the enormous tax difference, which was a glaring example of domestic production at the expense of foreign products (Pekkanen 2001: 65). The dispute, which actually is three disputes treated as one, started June 21 1995 when the EC requested consultations, and Canada and the US followed on 7 July 1995. The complainants claimed that spirits exported to Japan were discriminated against under the Japanese liquor tax system which, in their view, levies a substantially lower tax on “shochu” than on whisky, cognac and white spirits (WTO 2008). The “WTO-Alcohol”-dispute clearly builds upon the “GATT-Alcohol”-dispute. The Panel Report from 1987 and its conclusions thus became disputed. The EC said that since the Liquor Tax law had been changed, requesting the implementation of the 1987 Panel report was not enough; the establishment of a new panel was needed. The US on their side, said that the 1987 Report offered excellent guidance, and urged the Panel to complete the job started in 1987; to find that Japan’s taxes were discriminatory and inconsistent with Article III:2. Canada wanted the case to be directed by the 1987 report and that the factors articulated in the 1987 Report are determinative of the inconsistency of the Liquor Tax Law (WTO Panel Report DS8/10/11:15-16). Japan, on their side, claimed that that the findings in 1992 Malt Beverages had overturned the 1987 Report, that the findings in the 1987 Panel report should not guide deliberations of the present Panel, and that the present dispute were different from the “GATT-Alcohol”-dispute (ibid: 16-17).

According to Palmeter and Mavrodís (1998) “other than the texts of the WTO Agreements themselves, no source of law is as important in WTO dispute settlement as the reported decisions of prior dispute settlement panels(...)include the reports of GATT” (ibid: 400). In the “WTO-alcohol”-dispute, the WTO panel declined to follow the reasoning of two prior GATT panels because it was not persuaded by the reasoning in one and disagreed with the interpretation of the term “like product” in the other⁴ (ibid: 403). The WTO Panel therefore showed that it was independent of previous disputes concerning the same GATT articles. When it comes to the “GATT-Alcohol”-case and its factual findings, the WTO Panel said that after “following its independent considerations of the factors mentioned in the 1987 Panel Report”, the Panel agreed with the findings in the 1987 Panel Report, and that the responding member had “offered no further convincing evidence that the conclusion reached by the 1987 Panel Report was wrong” (WTO Panel Report DS8/10/11: 104). It did however state that “one case alone did not constitute a practice under the agreement” (Jackson 2006: 176) and the WTO Panel made its considerations of the facts in the dispute on an independent level. However, according to Jackson, this does not say that a prior case is irrelevant and it does create an “amount of precedent value” (ibid: 168). This could explain why Japan wanted the findings of the 1987 Report not to be considered.

4.2.1 Findings and conclusions of the Panel

The conclusions of the panel were the following:

- a) Shochu and vodka are like products and Japan, by taxing the latter in excess of the former, is in violation of its obligation under Article III: 2, of GATT 1994
- b) Shochu, whisky, brandy, rum, gin, genever, and liqueurs are “directly competitive or substitutable products” and Japan, by not taxing them similarly,

⁴ The reports were “United States - Taxes on Automobiles” and “1992 Malt Beverages”, respectively (WTO Panel Report DS8/10/11: 101)

is in violation of its obligation under Article III: 2, second sentence, of GATT 1994 (WTO AB-1996-2: 1-2)

The Panel then recommended that the Dispute Settlement Body request Japan to bring the Liquor Tax Law into conformity with its obligations under GATT 1994 (ibid.). In other words, the Complainants had won the dispute. However, it was not over, and on August 11 1996 Japan filed an appeal. Even though it supported the overall conclusion, the United States also appealed the Panel Report, because it found several errors in the findings of the Panel and the legal interpretations developed by the Panel in reaching its conclusions in the Panel Report. This case was one of the first to be handled by the new DSS, and the second time the Appellate Body (AB) had been used (Van den Bossche 2006: 307). Where the appeal by Japan is critical of the Panel Reports findings and interpretations related to the products in this specific case, the appeal by the United States is based on criticism on the more general level of treaty interpretation. The United States claimed

that the Panel erred in incorrectly characterizing adopted panel reports as "subsequent practice" within the meaning of Article 31(3)(b) of the Vienna Convention on the Law of Treaties (the "Vienna Convention").¹² According to the United States, adopted panel reports serve only to clarify, for the purposes of the particular dispute, the application of the rights and obligations of the parties to that dispute to the precise set of circumstances at that time (WTO AB-1996-2: 4)

Clearly, the United States did not want this case to create precedence in WTO disputes and saw that the this case could have long term implications that could later be used against them.

The AB's Report affirmed the Panel's conclusion that the Japanese Liquor Tax Law is inconsistent with GATT Article III:2, but pointed out several areas where the Panel had erred in its legal reasoning, mainly on the complaints made by the United States. The Appellate Report, together with the Panel Report as modified by the Appellate Report, was adopted on 1 November 1996 (ibid.).

4.2.2 Actions taken by Japan

Japan first claimed that immediate compliance was “ordinarily almost impossible” and stated that it required up to five years to implement the recommended increase in taxes, because of its government’s parliamentary minority and the effect of the proposed legislation on the liquor producing industry (Stoll & Steinmann 1999: 415). The Arbitrator found the reasonable period for implementation of the recommendations to be 15 months from the date of adoption of the reports i.e. it expired on 1 February 1998. Japan presented modalities for implementation which were accepted by the complainants (WTO DS8). Japan did deliver.

European Commissioner Sir Leon Brittan, who were in charge of external trade, said that “through the WTO the EU has succeeded in forcing changes to Japan's liquor tax laws“(Xinhua English Newswire 1997). After the lost trade dispute over tax rates on its shochu distilled spirits, Japan agreed to slash taxes on imports by 58%, and raise taxes on shochu (European Report 1999). It implemented its tax reform in three stages, starting October 1, 1997, second reform on May 1, 1998 and promised to implement the third and final stage of the reform on October 1 2000, at which the time rate for the remaining category of shochu would be harmonized with the existing rates for all other distilled spirits (Orr 1999).

4.3. Comparing the GATT and the WTO disputes

Looking at the “GATT-Alcohol”-dispute and the “WTO-alcohol”-dispute, one can almost say that the one led to the other. The fact that the complaining parties took the case to the WTO after they had tried it under the GATT shows that they were neither willing to yield nor that they were satisfied with the result of the GATT dispute. The time aspect of this case is relevant, and so is the increased pressure laid on Japan due to the fact that both Canada and the United States joined the EU as actual complainants in the WTO dispute and not just third parties as they were in the GATT dispute. Both these factors contributed to the Japanese compliance. But the legalized WTO DSS still played a prominent role.

Japan was going to reform its Liquor Tax Law in 1986 and did complete the reform in 1989 and followed with a reform in 1994. The planning of the 1986 Reform had therefore started after the EC had requested consultations under GATT, and Japan did block the formation of a panel for more than six months, relying on diplomacy outside the GATT to solve the case. When they were ruled against in the GATT, the reform they passed in 1989 was already planned on the domestic level. The revenue from the Liquor Tax was the third most important revenue source after the income tax and the corporation tax in 1985, amounting to 4.9 per cent of the total revenue (Panel report L/6216: 2), so this was clearly an important subject for the Japanese Government. When looking at the rhetoric used by the complainants in the “WTO-Alcohol”-dispute, one can see that they had not forgotten about the 1987 Panel Report, and the three complainants still requested that the WTO Panel find that Japan still violated its obligations. Although the EC said that since the Tax Law had been changed a new panel was needed, the arguments were the same. And Japan on their side still requested the Panel to find that its taxation system did not violate Article III. In both disputes, the panels stated that the dispute concerned the interpretation of Article III, and especially the term “like products”. In the 1987 Panel Report, “the Panel found that the traditional Japanese consumer habits with regard to shochu provided no reason for not considering vodka to be a like product” (Panel report L/6216: 25).

In the “WTO-Alcohol”-dispute, Japan argued that spirits, whisky/brandy and liqueurs are not “like products” to either category of shochu, within the meaning of Article III:2, first sentence, nor are they “directly competitive or substitutable product” to shochu, within the meaning of article III:2, second sentence (WTO Panel Report DS8/10/11: 96) Japan later argued before the AB “that “shochu” and whiskey were unlike products and it was basically a beverage for poorer people”(Xinhua English Newswire 1996). In 1985, the grading system pursues the objective of levying a high tax and high priced whiskies/brandies and an appropriately lower tax in regard to low quality and low priced whiskies/brandies largely drunk by people in the lower income bracket (Panel report L/6216: 3). Japan’s taxing system therefore had a social side to it. Jackson (2006) points out that this dispute touches on certain cultural attributes of

consumers, which can play a part in treaty interpretation (ibid: 187). The AB stated in this dispute that the term “like product” requires the AB to examine the phrase on a “case by case basis” and that the context of the language was crucial (ibid: 186). In this dispute, the products in question were found to be like products by both the GATT system and the WTO system. Japan had clearly lost.

The AB then stated that

The WTO agreement is a treaty - the international equivalent of a contract. It is self evident that in an exercise of their sovereignty, and in pursuit of their own respective national interest, the members of the WTO have made a bargain. In exchange for the benefits they expect to derive as members of the WTO, they have agreed to exercise their sovereignty according to the commitments they have made in the WTO agreement” (Marceau 2006: 341).

With this statement, the AB clearly plays on the credibility of the parties’ commitment. The principles for “hard” legalization set forward by neoliberals in chapter 3 are all working together in the “WTO-alcohol”-dispute. The GATT system made it possible for Japan to follow some of its own national interest when it comes to alcohol policy, since the GATT system always were based on consensus, negotiations and political compromise (Hovi 1996: 335). Japan could therefore under the GATT system change their Tax Law to the extent they found proper and in line with their domestic view. Under the WTO, they had to comply with the international agreement to a greater degree and their domestic alcohol policy was now affected not only by their national preferences, but also by the Dispute Settlement System of the WTO.

The Complainants were quite satisfied with WTO. As Mark Z. Orr, the Vice President of International and Trade with the Distilled Spirits Council of the United States says:

For the U.S. distilled spirits industry, The WTO dispute settlement mechanism has worked, and worked very well. At our request, the Office of the U.S. Trade Representative(USTR) has initiated or participated in dispute settlement proceedings

against the discriminatory tax measures imposed on imported distilled spirits products by Japan(...)A partial reform enacted in 1989 eliminated the most overtly discriminatory elements of the system, but left the system in place in its basic form. Subsequent efforts to persuade Japan to eliminate the remaining discrimination against imports proved fruitless(...)The leverage provided by the WTO dispute settlement allowed USTR negotiators to secure the U.S. distilled spirits industry's two primary market access objectives in Japan- the establishment of a nondiscriminatory tax regime in which U.S. distilled spirits products are taxed equally with domestic Japanese products and the elimination of tariffs on all U.S. distilled spirits to Japan (Orr 1999).

In 2008, the AP Worldstream could tell us that “The U.S., the 27-nation EU and Japan, by contrast, allow nearly all spirits to enter their markets duty-free” (AP Worldstream 2008). Were GATT made Japan do something, but still not follow the 1987 Report completely, the WTO dispute resulted in Japan acting in accordance with the international organization's law and to the satisfaction of the complainants. The assumption held by Zangl that smaller states will change their behavior due to legalization, is in this case valid.

5. The “US lumber”-dispute

The disputes in focus in this chapter concern a lengthy trade dispute between Canada and the United States. The topic of the disputes is softwood lumber from Canada. The dispute pair is actually two disputes under the GATT and six disputes under the WTO. I will for the purpose of this thesis treat these disputes as two, one under the GATT and one under the WTO. The disputes are:

- A) Canada versus the United States in 1987 and 1993 under the GATT system.
The disputes are “*United States - Initiation of a countervailing duty investigation into softwood lumber product from Canada*” from 1987, and “*United States - Measures affecting imports of softwood lumber from Canada*” from 1993. These disputes will be referred to as “The GATT lumber”-dispute.
- B) Canada versus the United States from 2001 to 2006 under the WTO system.
The first dispute, which later became several cases which I will describe below, were “*United States — Preliminary Determinations with Respect to Certain Softwood Lumber from Canada*”. This, and the following disputes, will be referred to as “The WTO lumber”-dispute.

In Zangl’s article, he points out that one of the weaknesses with his study is “that it would have been preferable to focus on a less powerful contender than the EU to test whether the judicialization of GATT/WTO procedures has had an effect on U.S. behavior towards both powerful and less powerful disputants” (Zangl 2008: 832). This dispute allows for that test to be made. The US - Canada softwood lumber dispute has been described as “the long-running and rancorous battle” that “stands out as the United States’ largest single trade dispute with its largest trade partner” (Lindsey et al 2000: 2), and as a “dispute so long running that interested parties rely on dynastic nomenclature to catalog the sordid details” (Ikenson 2005). It can therefore be considered ideal for the research question of this thesis, since it in addition to be treated under both GATT and WTO is a trade dispute where the single most powerful state in the world is the respondent.

At the core of the dispute, is the word “stumpage”. This refers to the fee Canadian lumber producers pay for the right to harvest trees from federally or provincially owned property known as “Crown Lands”. In contrast, US trees are harvested from privately owned land. American lumber interests assert that the effective rate of stumpage is below market value and therefore constitutes a subsidy. They also maintain that lax reforestation and other ancillary obligations contribute to subsidization and that, in addition, individual Canadian lumber producers price their products so as to dump softwood lumber in the American market (Carmody 2006: 666).

5.1 The “GATT Lumber”- dispute

This dispute can be dated back many decades, but it significantly heated up in 1982, and in 1983 the first countervailing duty (CVD) case was initiated by the U.S. Department of Commerce (USDOC) (Lindsey et al: 2). Countervailing duties, a tariff, is U.S. domestic firms’ legal recourse against subsidized imports. Domestic firms initiate the legal process by filing a petition with the USDOC and the U.S. International Trade Commission (ITC) alleging that imports have been subsidized by a foreign government. If USDOC determines that the imports have been subsidized and if the ITC rules that the domestic industry has been injured as a result of the imports, tariffs of the magnitude of the subsidy margin (determined by USDOC) will be imposed (Irwin 2002: 112). This investigation found that Canada did not violate US law with regards to subsidies (Lindsey et al: 2).

On September 26, 1985, Canadian Prime Minister Brian Mulroney requested the opening of trade talks with the U.S., where free trade was the gist of the request. One of the reasons for this decision by Canada was the concern over growing US protectionism, including lumber imports from Canada. In addition, the Canadian economy had for the prior ten years been performing badly (Weintraub 1986: 101). Then, in the spring of 1986, the USDOC reversed itself in a second CVD investigation and found that Canadian stumpage rates conferred a 15 % subsidy

(Lindsey 2000: 3). This led the US Reagan administration to impose duties on Canadian shingles and "shakes" - rough-hewn shingles, which two weeks later, in June, led Canada to slap tariffs on American-made computer parts, semiconductors and books and increased import fees on a number of other items (Browning 1986, Begley et al 1998: 209).

Less than two months later, the dispute was brought before GATT:

"In a communication dated 30 July 1986 (document SCM/76), Canada requested the Committee on Subsidies and Countervailing Measures ("the Committee") to establish a Panel to examine a dispute between Canada and the United States concerning the decision taken by the United States on 5 June 1986 to initiate a countervailing duty investigation on imports of softwood lumber products from Canada" (GATT SCM/83:1).

The Committee agreed to establish a panel on 1 august 1986. This was not blocked by the United States. The dispute then entered the consultation phase. The parties of the dispute, the terms of reference and the composition of the panel was then decided. The Panel met with the parties three times during the autumn of 1986. The Canadian view was that

There had been no material changes in the United States countervailing duty law and consequently there was insufficient evidence of the existence of a subsidy to justify the opening of a new investigation by the United States. Canada therefore considered that, in initiating a second investigation of these practices, the United States had acted in violation of Article 2:1 of the Code (ibid: 2).

In January 1987, the Panel was informed by Canada and the United States that a mutually satisfactory settlement of the dispute had been reached. The case therefore never reached the adjudication phase. A Memorandum of Understanding (MOU) between the two countries was presented to the panel. The MOU stated that

Under the terms of the Memorandum of Understanding, the United States is required to release bonds and refund deposits made pursuant to the preliminary affirmative

countervailing duty determination, and to state in the notice of termination of the investigation that this preliminary determination is henceforth without legal force and effect. Canada has undertaken to collect an export charge of 15 per cent ad valorem on exports of certain softwood lumber products made on or after 8 January 1987 from Canada to the United States (GATT SCM/83: 2)

The two Governments would consult semi-annually and otherwise at the request of either Government regarding any matter concerning the MOU, and the MOU could be terminated upon thirty days written notice by either Government (ibid.). The diplomacy of the GATT clearly prevented an escalation of this dispute.

In the time between this dispute and the one explained below, Canada and the United States signed a free trade agreement (1988) (Irwin 2002:140). Canadian officials and export manufacturers obtained significant support from important segments of the Canadian agricultural community for their view that a trade agreement was needed, both to stem US protectionism and enhance needed access (Skogstad 1992: 324). The election held in 1988 in Canada was also seen as an election on the Free Trade Agreement (Irwin 2002: 140). Canada unilaterally terminated the MOU in 1991, giving notice to U.S. 3 September (Panel Report SCM/162). The U.S. government responded immediately (4 October) by imposing interim duties on Canadian lumber under section 301 of the Trade Act of 1974, and then initiated a new CVD investigation (Lindsey et al 2000: 3). On October 8 1991, Canada requested consultations with the United States under Article 3:1 of the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the GATT (GATT SCM/162: 2).

The dispute before the Panel concerned (i) the suspension of liquidation and imposition of bonding requirements by the United States on 4 October 1991 under Section 304 of the Trade Act 1974 with respect to imports of softwood lumber from Canada, and (ii) the initiation by the United States on 31 October 1991 of a countervailing duty investigation on imports of softwood lumber from Canada (ibid.).

This dispute started in 1991, which was after the mentioned 1989 GATT reform DSPI. The possibility for U.S. to block the panel was therefore not present. The dispute then entered the consultations phase. Canada requested the panel to find that

The measures taken by the United States on 4 October 1991 in the form of a suspension of liquidation of entries of softwood lumber products from Canada and the imposition of bonding requirements on such entries were inconsistent with the obligations of the United States under Article 5:1, and were not justifiable as a form of "expeditious action" under Article 4:6 of the Agreement (GATT SCM/162: 8).

On these grounds, Canada wanted the panel to recommend that

the Committee on Subsidies and Countervailing Measures request the United States (1) to withdraw the bonding requirements imposed on 4 October 1991, release the bonds, refund with interest any cash deposits and amounts collected, and terminate the suspension of liquidation of entries of softwood lumber from Canada ordered on 4 October 1991, and (2) to terminate the countervailing duty investigation initiated on 31 October 1991 with respect to imports of softwood lumber from Canada (ibid.: 9).

The United States requested the Panel to find

that the measures taken on 4 October 1991 with respect to entries of softwood lumber products from Canada were fully consistent with Article 4:6 of the Agreement, and that the self-initiation on 31 October 1991 of a countervailing duty investigation of imports of softwood lumber products from Canada was fully consistent with the obligations of the United States under Article 2:1 of the Agreement (ibid.)

Japan presented arguments as an interested third party. They submitted their support of the Canadian claims that the measures taken by the U.S. on 4 October 1991 with respect to imports of softwood lumber from Canada were inconsistent with the obligations of the U.S. under the agreement, and that the CVD investigation had been

initiated in the absence of sufficient evidence (ibid: 89). The report of the Panel was adopted on 27 October 1993 and concluded that

- (a) the interim measures taken by the United States on 4 October 1991 with respect to imports of softwood lumber from Canada were inconsistent with Article 5:1 and could not be justified on the basis of Article 4:6 of the Agreement; and*
- (b) the initiation of a countervailing duty investigation by the United States on 31 October 1991 with respect to imports of softwood lumber from Canada was not inconsistent with the requirements of Article 2:1 of the Agreement (ibid: 117).*

The Panel therefore recommended to the Committee to request the United States, with respect to imports of softwood lumber from Canada, to terminate the bonding requirement, release any bonds, refund any cash deposits and terminate the suspension of liquidation of entries made during the period of application of the inconsistent interim measures imposed in October 1991 under the authority of Section 304 of the Trade Act of 1974 (ibid: 118). Canada had succeeded in their fight against their mighty neighbor. Would the United States so comply with the ruling?

5.1.2 Actions by the U.S. and the SLA of 1996

The US agreed to refund more than \$800 million in duties collected, and both countries agreed to enter into a “dialogue” on future lumber negotiations (Lindsey et al 2002: 3). The GATT adjudication had clearly worked for Canada. Canada and the United States later reached an agreement referred to as the Softwood Lumber agreement (SLA), which were to run from 1 April 1996 to 31 March 2001. The SLA imposed high duties on any imports of Canadian lumber above a certain threshold. Anything over 14, 7 billion board feet of lumber per year were subject to duties (Irwin 2002: 59, Lindsey et al 2000: 3). Canada agreed to the SLA because of the fear of another CVD case, which had been costly on the Canadian softwood lumber industry and to avoid changes to U.S. trade law which neutralized Canada's victory in last lumber case (Lindsey et al 2000: 3, Campbell 2005). And as part of the agreement, the

U.S. agreed not to pursue trade remedy actions under the CVD or other trade laws, and also terminated all actions brought by the American lumber industry in U.S. courts (Lindsey et al 2002:3, Carmody 2006: 666).

When the SLA expired 31 March 2001, Canadian lumber producers were allowed to export softwood lumber to the U.S. without limit (Carmody 2006: 666). In response the U.S. Coalition for Fair Lumber Imports immediately filed a countervailing duty petition. On May 23 the ITC made a preliminary determination that while Canadian softwood lumber exports to the United States were not injuring the domestic industry, there was a threat of material injury. This determination was followed on August 9 by the DOC's preliminary determination that Canadian softwood lumber exports to the United States were being subsidized at the rate of 19.31% (Carmody 2006: 666, Ikenson 2005). This led to the “WTO softwood lumber”-dispute.

5.2. The “WTO lumber”- dispute

This dispute includes six disputes from 2001 to 2006. As mentioned, this dispute is one of the largest to involve the United States. What makes the dispute even larger is that it has been treated under both the WTO's and the North American Free Trade Agreement's (NAFTA) dispute settlement systems. Since this thesis is about the WTO DSS, I will refrain from discussing the proceedings under NAFTA. According to Carmody (2006) the difference between the two agreements is that the WTO Agreement establishes a regime of international law, whereas NAFTA Chapter 19 refers back to a country's own domestic law (ibid:672). In the following pages I will briefly explain the relevant details of each WTO dispute chronologically:

1) DS236 - Preliminary Determinations with Respect to Certain Softwood Lumber from Canada

It started with dispute DS236 on 21 August 2001, when Canada requested consultations with the US concerning the preliminary countervailing duty

determination and the preliminary critical circumstances determination made by the US Department of Commerce on 9 August 2001, with respect to certain softwood lumber from Canada (WTO 2008). On 17 September 2001, Canada and the U.S. held consultations but failed to reach a mutually satisfactory resolution of the matter. On 25 October, Canada requested the establishment of a panel to examine the matter and on 5 December 2001 the DSB established a panel (Panel Report WT/DS236/R: 1).

Canada requested the panel to find that the preliminary countervailing duty determination violated 7 different articles in the SCM agreement and article VI:3 of GATT 1994, and that US countervailing duty law regarding expedited and administrative reviews and the application of that law in the case resulted in failure by the U.S. to ensure that its laws, regulations and administrative procedures were in conformity with its WTO obligations under both the WTO and SCM agreements (Panel Report WT/DS236/R: 3). Canada therefore wanted the panel to

recommend that the United States bring its measures into conformity with the SCM Agreement and the WTO Agreement, including by lifting the suspension of liquidation for the period of 19 May through 16 August 2001, and making company-specific expedited and administrative reviews available to exporters and producers subject to any countervailing duty order that may be issued as a result of the Lumber IV investigation. (Panel Report WT/DS236/R: 3).

The United States requested that the Panel reject Canada's claims in their entirety. During the time of the investigation and decision making of this case, both the DOC and the ITC made their investigations into Canadian lumber producers, and the result was a final CVD rate of 18.79 percent and an average final antidumping rate of 8.4 percent, for a combined average total rate of 27.22 percent. This had an impact on the Canadian industry and some smaller mills and related businesses were forced to shut (Carmody 2006: 667).

On 27 September 2002, the Panel Report was circulated. The Panel held that the Canadian provincial stumpage programs were a "financial contribution", but

nevertheless concluded that the USDOC's imposition of provisional measures based on the preliminary countervailing duty determination was inconsistent with the US obligations under Articles 1.1 (b), 10, 14, 14 (d), and 17.1(b) of the SCM Agreement (WTO DS236, Carmody 2006: 666). Canada's International Trade Minister, Pierre Pettigrew said in a release that "WTO has found in favor of our position that the U.S. preliminary subsidy determination was flawed and disproves the methods of calculation (...) this decision reinforces our position" (Resource News International 2002). Canada had won the first battle, but there was more to come. The United States namely stated that the measures at issue in this dispute were no longer in effect and that no action was required to implement the report. Canada on their side claimed that the U.S. policies deemed illegal by the Panel remained unchanged (WTO DS236). And already before the circulation of the report, Canada had initiated more disputes on the same matter. Neither side was ready to give up.

2) *DS247 - Provisional Anti-Dumping Measure on Imports of Certain Softwood Lumber from Canada*

On 6 March 2002, Canada requested consultations under Article 4.8 of the DSU (urgency procedure) with the United States regarding an anti-dumping measure applied by the US to imports of softwood lumber from Canada. The US, although accepting the request for consultations, however did not accept that this was a case of urgency for the purpose of Article 4.8 of the DSU (WTO DS247). Canada could have used the article 4.3 in the WTO DSU to make this request into a dispute, but did not. Most likely, they decided to use their resources on the next case; DS257.

3) *DS257 - Final Countervailing Duty Determination with respect to certain Softwood Lumber from Canada*

On 3 May 2002, Canada requested consultations with the US. The request concerned the final affirmative countervailing duty determination by the US Department of Commerce issued on 25 March 2002, with respect to certain softwood lumber from

Canada (WTO DS257). On 18 July 2002, Canada requested the establishment of a panel. The establishment of a panel was deferred by the Dispute Settlement Body (DSB) until 1 October 2002, when it was finally established. The EC, India and Japan reserved their third-party rights to participate in the panel proceedings. On 8 November 2002, the panel was composed. On 29 August 2003, the Panel report was circulated to Members. The Panel found that

the USDOC Final Countervailing Duty Determination was inconsistent with Articles 10, 14, 14(d) and 32.1 SCM Agreement and Article VI:3 of GATT 1994. The Panel decided to apply judicial economy as regards Canada's claims under Article 19.4 SCM Agreement and Article VI:3 of GATT 1994 concerning the methodologies used to calculate the subsidy rate; and its claims of violation of the procedural rules of evidence set forth in Article 12 SCM Agreement. Further to Canada's statement at the first substantive meeting of the Panel with the parties that it did not consider it appropriate to press its claims under Articles 10, 11.4 and 32.1 of the SCM Agreement concerning the initiation of the investigation, the Panel also refrain from addressing and making a ruling on these claims. (WTO DS257).

The Panel recommended that the DSB requests the United States to bring its measure into conformity with its obligations under the SCM Agreement and GATT 1994. The U.S. decided to appeal, after withdrawing its appeal once, on 21 October 2003. The Appellate Body (AB) report was circulated to members on 19 January 2004 (due to the time required for completion and translation of the Report, the AB had informed that the normal 60- day period would not be upheld). The AB agreed with the panel that the harvesting rights granted by Canadian provincial governments could substitute a "provision of goods" in terms of the "financial contribution" element of a subsidy (Carmody 2006: 667). The AB then

reversed the Panel's interpretation of Article 14(d) of the SCM Agreement and the Panel's finding that the US had improperly determined the existence and amount of the "benefit" resulting from the financial contribution provided. Then the Appellate

*Body found that it was **unable to complete the legal analysis** of whether the US had correctly determined benefit in this investigation, due to insufficient factual findings by the Panel and insufficient undisputed facts in the Panel record (WTO DS257).*

The Panel nevertheless agreed that the DOC had acted inconsistently with both the WTO SCM agreement and GATT 1994 by failing to analyze whether subsidies were passed through in sales of timber to unrelated producers of softwood lumber (Carmody 2006: 667). The AB recommended the U.S. to bring its inconsistent measures into compliance with the SCM Agreement and GATT 1994 (International Law Update 2004). To comply with the WTO's recommendations, the DOC performed a pass-through analysis in respect of certain transactions, though the new rate of subsidization was calculated to be no different than the old one (Carmody 2006: 668). The implementation by the U.S. did not please Canada, and considering that the measures allegedly taken by the United States to comply with the DSB's recommendations and rulings were inconsistent with US obligations under relevant WTO Agreements, on 30 December 2004 Canada requested the DSB of the establishment of a panel under Article 21.5 of the DSU (WTO DS257). The compliance panel found that the U.S. measures were inconsistent with its obligations (Carmody 2006: 667). This report was adopted 20 December 2005. This dispute, DS257, reflects the complexity of the entire "WTO-Softwood lumber"-dispute. The actions by the countries clearly show the other part that neither is willing to yield. According to Pruitt's (1991) three strategies towards an agreement, this will eventually lead to problem solving. At the same time, since the Report gave both sides partially right, the incentives to continue the dispute were also present. And as seen below, Canada had initiated disputes that still were under investigation by the WTO. And the United States, using the AB, still had the ability to delay the adoption of reports while they were collecting duties on Canadian lumber.

4) DS264 - *Final Dumping Determination on Softwood Lumber from Canada*

This case started on 13 September 2002 when Canada requested consultations under Article 4.8 of the DSU (urgency procedure) with the US concerning the final affirmative determination of sales at less than fair value (dumping) with respect to softwood lumber products from Canada. Canada considered these measures and, in particular, the determinations made and methodologies adopted therein by the DOC under authority of the United States *Tariff Act of 1930*, to violate 15 articles of the *Anti-Dumping Agreement* and Articles VI and X:3(a) of the GATT 1994 (WTO DS264).

The panel report was circulated on 13 April 2004 and found that the DOC had acted inconsistently with the WTO Antidumping Agreement by calculating antidumping margins on the basis of a weighted average comparison employing a “zeroing”⁵ methodology (Carmody 2006: 668). All other claims by Canada failed. The U.S. appealed this decision, but the AB, on 11 August 2004, upheld the Panel decision. The AB also reversed the Panel’s finding that the United States did not act inconsistently with the Anti-Dumping Agreement in its calculation of one of its ITC investigations (WTO DS264). This dispute, which was settled before the DS257, was a victory for Canada, and the United States stated that they were going to implement, within a reasonable period of time, the recommendations and rulings of the DSB in a manner that respected its WTO obligations (ibid). First, the countries made an agreement on a date within “reasonable period of time”, but in May 2005 Canada claimed that the United States had not delivered concerning implementation. Canada requested the DSB of the establishment of a panel under Article 21.5 of the DSU (implementation). This Panel ruled against Canada’s claims, Canada made an appeal, which on 15 August 2006 reversed the Panel’s findings and stated that the United States acted inconsistently with regards to its WTO obligations (ibid). This dispute was a continuous victory for Canada, and the AB verdict was also the last made by the WTO Dispute Settlement Body in the six disputes here described. China, the EC, India, Japan, New Zealand, Thailand had also participated in a lengthy question round

⁵ This means to potentially depress the average export price and increasing the rate of dumping (Carmody 2006:668).

over the calculations made by the United States. The U.S representatives disagreed with the interpretations made by these third parties (WTO DS264 Panel Report). Nevertheless, the most powerful state in the world was ruled against, and their policy was not only deemed inconsistent with WTO obligations, their reputation and commitment credibility was now under pressure from other trade partners as well as Canada.

5) *DS277 - Investigation of the International Trade Commission in Softwood Lumber from Canada*

On 20 December 2002, Canada requested consultations with the United States regarding the investigation of the USITC in Softwood Lumber from Canada and the final definitive anti-dumping and countervailing duties applied as a result of the USITC's final determination made on 2 May 2002, that an industry in the United States is threatened with material injury by reason of imports of softwood lumber from Canada that the Department of Commerce has determined are subsidized and sold in the United States at less than fair value (WTO DS277).

The panel report of this case stated that the that the anti-dumping and countervailing measures imposed by the US on imports of softwood lumber from Canada are inconsistent with the US obligations under both the Anti-Dumping and the SCM agreement, and recommended that those measures be brought into conformity with the US obligations (ibid). Considering that the measures allegedly taken by the United States to comply with the DSB's recommendations and rulings were inconsistent with US obligations under relevant WTO Agreements, on 14 February 2005 Canada requested the DSB of the establishment of a panel under Article 21.5 of the DSU. The Panel found that the determination of the US ITC implementing the Panel and DSB recommendations in the original dispute was not inconsistent. Canada then appealed to the AB (ibid). On 13 April 2006, The AB reversed the ruling and found the implementation and compliance inconsistent. They were however unable to complete the analysis and determine whether the USITC's Section 129 determination is

consistent or inconsistent with the United States' obligations under the agreements in question. As seen, this has happened several times in the “WTO-Softwood lumber”-dispute. Jackson (2006) explains that this is a common phenomenon in the WTO:

The Appellate Body has found itself in an odd situation occasionally, when it has decided that the panel’s reasoning followed a path that the Appellate Body felt was incorrect. Therefore, as an exercise in “completing the analysis”, the appellate body needed to pay attention to a different legal situation, which however, had not been taken up by the first level panel, so that the facts supporting that issue were therefore not available. This has led the Appellate Body to decline to take up the question that might otherwise have finished the analysis (ibid: 181).

On 9 May 2006, the DSB adopted the AB report and the Panel report, as reversed by the AB report (WTO DS277). A sixth case, *DS311 - Reviews of Countervailing Duty on Softwood Lumber from Canada*, which started 14 April 2004, is also part of the “WTO-Softwood lumber”-dispute, but this was never taken any further than a registered complaint, and a lot of the issues at stake were being treated in other cases. After five years and six disputes, the United States’ CVD practice had been ruled illegal according to the WTO agreement. Canada had proven their persistence by not yielding and although their policy towards lumber (the stumpage fee) had been said to constitute a subsidy, the verdicts in the WTO supported their claim. They also had the support of other central states on the international trade arena. Could these facts make the United States, the world’s leading free trade supporter, to change their behavior?

5.2.1. A solution

On 12 October 2006, the United States and Canada informed the DSB that they had reached a mutually agreed solution under Article 3.6 of the DSU in the disputes WT/DS236, WT/DS247, WT/DS257, WT/DS264, WT/DS277 and WT/DS311 (WTO DS236). This reflects the general desire in the WTO to settle dispute among the parties by agreement and in the view of the WTO, makes the case solved.

Considering the number of cases, the various rulings by the WTO DSB and by the AB, the lack of resources to investigate, and the possibility of a trade war between the countries, which are each others' largest trade partners, this is not a surprising outcome. A standard assumption in bargaining theory is that in order to be a candidate for final agreement, a solution must satisfy two requirements; 1) each party must be better off with the agreement than without it, and 2) the settlement must be Pareto optimal, a condition which is fulfilled for settlement A if no alternative settlement B exists such that at least one party is better off with B than with A, while at the same time no party is better off with B than with A (Hovi 1998: 59). In this case, Canada needed to strike an agreement to get a portion of the funds collected back and to at least lower the duties, and at the same time rid itself of a costly trade dispute. The United States got to keep their duties at a satisfactory level, and rid them of a trade dispute which ended unfavorably, and ended a behavior that could undermine the legitimacy and rules of organizations, The WTO and NAFTA, they helped establish and had a national interest in.

At the same time, since this case holds accusations of subsidization on the Canadian account, it becomes easier for the U.S to legitimize its non-compliance, both at the international and domestic level. Keeping in mind, that the verdicts from the WTO DSB were not "complete" victories for Canada (that the harvesting rights granted by Canadian provincial governments could substitute a "provision of goods" in terms of the "financial contribution" element of a subsidy), the U.S. held a stronger negotiation position.

The WTO stated that it did not have the resources necessary to complete a full investigation into every aspect of the case. This has happened earlier; in the DS44 Fuji Film case (Jackson 2006: 181). Because of the recourse problem, Jackson claims that certain kinds of issues (competition included) seem out of reach of the current WTO Dispute Settlement System, and there is a tendency for the DSS to rely very heavily on the fact statements of the parties, unless there is a specific refutation

(ibid.). A case of this magnitude, and with diverging views on the facts, is not surprisingly solved with a settlement.

5.2.2 The new agreement

The agreement was signed on 12 September 2006 and made effective one month later. It is described by the U.S. Trade Representative in these terms:

Under the terms of the Agreement, the United States and Canada will end a large portion of the litigation over trade in softwood lumber and unrestricted trade will occur in favorable market conditions. When the lumber market is soft, Canadian exporting provinces can choose either to collect an export tax that ranges from 5 to 15 percent as prices fall or to collect lower export taxes and limit export volumes. The agreement will also include provisions to address potential Canadian import surges, provide for effective dispute settlement, distribute the antidumping and countervailing (anti-subsidy) duty deposits currently held by the United States, and discipline future trade cases. The Agreement will also establish a bi-national working group to discuss provincial policy reforms (USTR 2006).

It was agreed that \$4 billion of the \$5 billion in penalties collected by the U.S. on softwood imports from Canada since 2002 would go back to Canadian producers (AP Worldstream 2006). There are various views on the agreement. Daniel Ikenson at the libertarian Cato Institute was skeptic and clearly takes a realist perspective:

Calling the U.S.-Canada Softwood Lumber Agreement (2006) an “agreement” mocks the fact that the Canadians had no viable alternative but to sign on the dotted line. One option was to endure the cost and uncertainty of continuous litigation, continued restrictions on their lumber exports, and the specter of never again seeing the \$5.3 billion in duties collected illegally by U.S. Customs on previous exports. The other option was for Canadians to agree to impose export restraints (in the form of export taxes or quotas) on their lumber and see the return of about 80 percent of that \$5.3 billion (Ikenson 2006).

He is backed by Jack Layton, the leader of the Canadian New Democratic Party who called the agreement "outrageous, it's a sellout, it's a crime that the Americans would keep a billion dollars of money that seven decisions have now said they shouldn't have" (Crutsinger 2006). Thus, the agreement made the outcome of the case better for the U.S. than strictly following the WTO adjudication. Looking at the free trade aspect of the agreement, Gary Hufbauer, an economist at the Institute for International Economics, said that "This is all organized to keep competition down and prices high for U.S. producers" (ibid.). Jerry Howard, executive vice president of the National Association of Home Builders, was also not satisfied and claimed that "for an administration that espouses free trade, there is no logical reason to ... engage in one-sided negotiations that would provide a massive subsidy to the U.S. timber industry at the expense of millions of American consumers" (ibid.).

The chairman of the Coalition for Fair Lumber Imports, Steve Swanson called "the agreement (...) a compromise on the part of both countries", and stated that "on balance, the agreement is in the interest of U.S. sawmills and their workers." (PR Newswire 2006). Keeping in mind that the Coalition is the one that initiated the CVD cases, their satisfaction is a clear sign of a favorable outcome on behalf of the U.S. As part of the agreement, the Coalition members were to receive \$500 million of the collected duties during the period from 2001-06. Lawmakers from timber-producing U.S. states praised the agreement. The fact that unilateral reduction of tariff barriers is beneficial to the country granting it, whether or not other countries reciprocate (Hovi 1998: 69) can in this case show us that one special interest group in the U.S. got the Governments backing at the expense of another. One study on the impact of the lumber barriers have shown that as a result, in 2000, the average cost of a new home was raised, thus prizing 300.000 American families out of the housing market (Irwin 2002: 60).

5.3. Comparing the GATT and the WTO disputes

Compared to the MOU from 1987, the new agreement of 2006 is quite similar. Chi Carmody looks at the case from 2001 to 2006 and finds that both the CVD rates and the antidumping rates were lowered, and claims that although “the U.S. and Canada might appear to be back where they began - that is, with a politically brokered settlement - the litigation probably helped them get there” (Carmody 2006: 674). The role of the litigation needs to be questioned. Looking at the negotiation theory and the three strategies contending, yielding and problem solving, this case could be seen as a display case. Canada started out contending in 1986, then yielding and problem solving with the MOU in 1987. Canada was contending again between 1991 and 1993, and moved towards yielding and problem solving with the SLA in 1996. Canada again went back to contending again in 2001 until 2006, and ended up yielding and then problem solving in 2006 with the new agreement. And with a new agreement which policy resembles both previous agreements, one can claim that the U.S. had worn the Canadians out and that the U.S., with its continuous contending and appeals in the WTO, used the litigation to show that it had no intention to strictly comply with the WTO DSU, nor to completely open up its market. The goal for Canada has been free trade, which they did not have and did not get. Instead, after several cases in both the WTO and NAFTA, they got a new settlement that still demands them to collect an export tax. The litigation did really bring out the complexity of this case, but the increased precision, obligation and delegation of the WTO could not change the outcome compared to the GATT mechanism.

5.4 No change in U.S. behavior

The “GATT-lumber”- dispute and the “WTO-lumber”- dispute are the same dispute treated under two different dispute settlement systems. The outcomes of the two are however more or less the same. They both ended in a politically brokered agreement. Looking at the new quasi-judicial WTO DSB, it seems as it had little or no effect. The disputes under the GATT system ended with a negotiated settlement, so did the WTO disputes. Although the duties were lowered for Canada, and funds returned, this also happened in the 1993 dispute, which later ended in an agreement (The SLA of 1996).

Goldstein and Martin (2000) analyses the domestic requisites of free trade and finds potential negative effects of legalization. When they considered cooperation with the trade regime to be a function of the interests of domestic political actors, they question the assumption that increased legalization leads to more trade openness (ibid: 630). One of the crucial roles for the WTO is to secure reciprocity. By doing this, it create an incentive for the export competing businesses to work for trade liberalization, and thereby creating a counterweight to the import competing businesses (Hovi & Underdal 2000: 72). Increasing precision under the WTO offers more information to contending domestic interest groups, and in some stages additional information may serve to strengthen protectionists interests, and Goldstein and Martin says that legalization may undermine the domestic political balance between compliance constituencies and those who contest international commitments (Kahler 2000: 675). This case backs that view. Although Canada won the disputes, the statement by the WTO that the “stumpage” could be a subsidy gave the Coalition for Fair Lumber Imports stronger arguments against free traders in the U.S. This case would probably have ended the same way independently of diplomatic or judicial dispute settlement, and the number of appeals made it possible to stall the WTO Lumber case for several years and for the U.S. to show determination not to yield.

There are however indications that neither the Canadians nor the Coalition for Fair Lumber Imports are ready to quit the dispute. A year after the settlement, in October 2007, the Coalition for Fair Lumber Imports sharply criticized recent Canadian announcements of yet more taxpayer subsidies for its lumber industry (U.S. Newswire 2007). Disputes over the section of the softwood lumber agreement that requires Canadian lumber exporters to choose whether to pay export fees of up to 15 percent or pay a capped 5 percent fee and export less lumber are still happening, where U.S. accuses Canada of manipulating this section to give its lumber producers an unfair advantage. The lumber industry estimates that Canada has failed to collect one-third of the export taxes it committed to collect under the agreement. This was in December 2007 (Ravana 2007). It is quite possible that this trade dispute is not yet over.

6. The “EC Sugar”-dispute

The disputes in this chapter concerns two disputes under GATT and three disputes under the WTO. The disputes is about EC sugar export subsidies. The disputes are:

- A) Australia and Brazil versus the EEC under the GATT system. The disputes are “*European communities - refunds on exports on sugar*” from 1979 and “*European communities - refunds on exports on sugar complaint by Brazil*” from 1980. The disputes will be referred to as The “GATT-Sugar”-dispute.
- B) Australia, Brazil and Thailand versus the EC under the WTO system. The disputes are “*European Communities — Export Subsidies on Sugar (DS265)*” from 2002, “*European Communities — Export Subsidies on Sugar (DS266)*” from the same year and “*European Communities — Export Subsidies on Sugar (DS283)*” from 2003. The disputes will be referred to as The “WTO-Sugar”-dispute.

In his article, Zangl (2000) suspects that the effect of the legalization “might well be limited to disputes among roughly equally powerful actors such as the United States and the EU” (ibid: 847). The power relationships between the parts in this dispute make it possible to test if this suspicion is valid. It also enables the researcher to see if the legalization can have an effect on perhaps the greatest source of disagreement in world trade today, namely agricultural policies.

There are two sources of sugar in the world. Cane is a tropical crop and represented 60 % of the total world sugar production in 1984. The other is beet, which is a temperate crop and represented the remaining 40 % (Mahler 1984: 710). Beet production has been subjected to subsidies, protection and minimum price guarantees, and it is likely that without this government backing beet would not have been produced, since it generally has been more costly than cane to produce, and there have been an oversupply of sugar in the world for almost the entire 20th century (ibid: 711, 719). Beet is what is grown in Europe. Since 1902 there have been several

international sugar agreements, but in the years leading up to the “GATT-sugar” dispute, Europe did not participate in these agreements. The EEC sugar policy, which is a part of the Common Agriculture Program (CAP), resulted in a “rapidly growing surplus of high-priced, subsidized Beet sugar that it could dispose of on the world market only by means of extensive export subsidies” (ibid: 725). The common agricultural policy on sugar, which came into force on 1 July 1968, has two main objectives: to ensure that the necessary guarantees in respect of employment and standards of living in a stable market are maintained for Community growers of sugar beet and sugar cane; and to help guarantee sugar supplies to the entire Community or to one of its regions (GATT L/5011: 11). Brazil and Australia, on their hand, relied almost entirely on the free market for sugar production. Australia had also had preferential trade with Britain under the Commonwealth Sugar Agreement, which had ended when Britain joined the EEC in 1973 (Mahler 1984: 721).

6.1 The “GATT Sugar”- dispute

The dispute started 25 September 1978 when Australia presented a complaint that was circulated to the contracting parties. In the complaint, Australia claimed that the refunds on exports of sugar applied by the European Communities were inconsistent with the European Communities' obligations under the GATT, and furthermore requested the setting up of a panel to examine the problem (GATT L/4833:1). A panel was established on 6 November 1978. The EEC did not block the formation of a panel. Australia's arguments were that EEC sugar export subsidies was not consistent with the obligations of member States of the European Communities under the GATT and had resulted in Community exporters having more than an equitable share of the world export trade in sugar in the terms of GATT Article XVI. It also claimed that the policy harmed the Australian interest and that it nullified benefits Australia had of the GATT in addition to harming the objectives of GATT (ibid: 2). The GATT 1947 Article XVI: 1 states that

If any contracting party grants or maintains any subsidy, including any form of income or price support, which operates directly or indirectly to increase exports of

any product from, or to reduce imports of any product into, its territory, it shall notify the CONTRACTING PARTIES in writing of the extent and nature of the subsidization, of the estimated effect of the subsidization on the quantity of the affected product or products imported into or exported from its territory and of the circumstances making the subsidization necessary. In any case in which it is determined that serious prejudice to the interests of any other contracting party is caused or threatened by any such subsidization, the contracting party granting the subsidy shall, upon request, discuss with the other contracting party or parties concerned, or with the CONTRACTING PARTIES, the possibility of limiting the subsidization (GATT 1947).

This article is clearly an example of the diplomatic focus of the dispute settlement procedure in the GATT. The representative from the EEC argued that the regulations concerning sugar had been notified to the GATT pursuant to Article XVI: 1. He also claimed that the EEC was inconsistent with GATT only if their practice resulted in more than an equitable share of world export trade (GATT L/4833:2).

The Panel then made a detailed examination of sugar export statistics to see if increased Community sugar exports had displaced Australian sugar exports (ibid: 19). The increased share of the EEC was according to Mahler an effect of the subsidies and the fact that the EEC did not participate in the International Sugar Agreement (Mahler 1984: 726). The Panel found that Community sugar exports had directly displaced Australian exports only to a limited extent and in a few markets, and concluded that it was not in a position to reach a definite conclusion that the increased share had resulted in the European Communities "having more than an equitable share of world export trade in that product", in terms of Article XVI: 3. It still noted that the Community system for granting refunds on sugar exports and its application had contributed to depress world sugar prices in recent years and that thereby serious prejudice had been caused indirectly to Australia, *although it was not feasible to quantify the prejudice in exact terms* (GATT L/4833: 27).

The Panel found that the Community system of export refunds for sugar did not comprise any pre-established effective limitations with regards to production, price or the amounts of export refunds and constituted a permanent source of uncertainty in world sugar markets. It therefore concluded that the Community system and its application constitute a threat of prejudice in terms of Article XVI: 1. The Panel found itself unable to say what benefits accruing to Australia had been nullified or impaired (*Ibid*).

In the Panel Report there is no suggestion to the Contracting Parties to recommend any action by either party as a solution to the case. This Panel Report was adopted 6 November 1979.

The Brazil dispute started 10 November 1978. The argument laid forward by Brazil were the same as Australia; EEC exporters had more than an equitable share of exports, caused or threaten serious prejudice to Brazil's interest and nullified Brazil's benefits. The panel was established 29 January 1979 and the formation of a panel was not blocked by the EEC. The representative of Brazil expressed the opinion that this Panel should proceed from the general findings and conclusions arrived at in the complaint by Australia (the conclusions that claimed that the EEC did threaten prejudice and that the increase in export was a cause of subsidies) (GATT L/5011: 2). The EEC pointed out that in the Australia case the Panel concluded that the EEC had notified the GATT pursuant to Article XVI: 1, that the EEC did not have more than an equitable share of world export trade and that possible impaired benefits on the Australian account had not be made out (*ibid.*: 3).

The Panel then investigated if the EEC sugar policy had resulted in more than an equitable share of the world export trade in terms of Article XVI: 3, had harmed Brazilian interests in terms of Article XVI: 1, and that the application of the Community system was not in conformity with the guidelines for joint action stipulated in Article XXXVIII to further the principles and objectives of Article XXXVI (*ibid*: 16). The Panel then concluded that

- 1) On the basis of the evidence available to it in this particular case, it was not able to conclude that the increased share had resulted in the European Communities "having more than an equitable share of world export trade in the product", in terms of Article XVI: 3 (ibid: 24);
- 2) The EEC sugar policy contributed to depress prizes and therefore "constituted a serious prejudice to Brazilian interests" and that the EEC system "constituted a permanent source of uncertainty in world sugar markets" and thereby a threat of serious prejudice (ibid);
- 3) For this time-period (1978-9) and for this particular field, the European Communities had not collaborated jointly with other contracting parties to further the principles and objectives set forth in Article XXXVI, in conformity with the guidelines given in Article XXXVIII (ibid.).

The report was adopted on 10 November 1980.

6.1.1 Actions taken by the EC

The conclusions reached in these two cases are quite similar, with the exception that in the Brazil dispute that the EEC was also said to not collaborate with the principles and objectives in Articles XXXVI and XXXVIII, which concerns the urgency in raising the standards of living and the progressive development of less developed countries, and the willingness of the Contracting Parties to collaborate jointly for the benefit of less - developed countries (GATT 1947: 53-7). Still, it is not possible to say that this was a clear cut victory for Australia and Brazil. The panel did not find that the EEC policy gave the EEC countries a greater share of the export market, and it did not, as it did in the "GATT-alcohol"-dispute, suggest that the Contracting Parties should give any recommendations about what actions the EEC should take towards its policy. In a similar dispute concerning EEC restrictions on imports on apples from Chile adopted on the same day as the Brazil dispute, the Panel reached the conclusion that "the Contracting Parties should recommend that the EEC and Chile consult bilaterally with a view to arriving at a mutually satisfactory solution" (GATT L/5047:

16). No such suggestion was made in the two sugar disputes. The word “violation” is also not mentioned in the conclusions.

The EEC did revise its CAP sugar regime in 1981. Talk about reform of the Common Agriculture Program on a general level had gone on for many years already, and had also caused problems within the EEC (Runge & Witke 1990: 255, Marsh 1977). The CAP sugar reform dealt with quotas. In 1984, Mahler wrote that “it is still too early to tell whether the new provisions will result in a significant decline in Community production” (Mahler 1984: 728). The Australian Government did not accept that the new sugar regime relieved the EEC of the charge of violating Article XVI, but the EEC responded that these accusations were totally unjustified (ibid.). The Economist claimed in 2005 that the sugar regime had been untouched since 1968 (Economist 2005) and is supported by Gibb (2004). Clearly, the outcome of these two disputes was that the EEC carried on with their policy virtually unchanged. Hudec (1998, in Tangermann 2002: 255), when studying the history of GATT’s dealing with Article XVI: 3 (concerning exception for agricultural export subsidies), concludes that

The structure of Article XVI: 3 exposed it to [several] weakening influences. The problem was not just that no one knew what “equitable share” meant. It was that every aspect of the rule required tracing the market effects of the subsidy in question. Over and over again, panels found a correlation between the timing of a new subsidy and a large increase in market share, but time and time again panels were unable to convince themselves that the former was the cause of the latter (...) Many governments were committed to price support programs that were generating surpluses that had to be disposed of, and unless governments could be persuaded, or forced, to change those programs they were not going to give up the export subsidies that allowed them to solve this problem (ibid.).

In 1986, the Uruguay round started which 9 years later ended with the creation of the WTO. Agriculture, which sugar is a part of, has been one of the most disputed issues in the trade negotiations leading up the creation of the WTO and in the trade negotiations after the WTO. From 1947 to 1994, average world tariffs declined from

38 % to 4 % (Oatley 2004: 21). The tariff reductions have mainly occurred in manufactured goods. In agriculture, protectionism, export subsidies and other non-tariff barriers have remained and constitutes a significant barrier in the areas where developing countries have their comparative advantage (Snoen 2003: 33, Oatley 2004: 165). Hudec (1998, in Tangermann 2002: 254) states that the GATT was a “conspicuous failure in reducing barriers and other distortions to trade in agricultural products” (ibid.)

Brazil and Australia is part of the Cairns group, which has been particularly critical of the agricultural policy of the developed countries. In 1989, the Cairns group members told trade officials meeting in Geneva that they would obstruct progress on the Uruguay round of tariff-reductions under the GATT “unless Europe and America start to talk sense on agriculture” (Economist 1989). The Uruguay round went on for five years with several quarrels over agriculture (Economist 1992, 1993). In April 1994 the round was completed and one year later the WTO was established with a new dispute settlement system and a new agreement on agriculture (Tangermann 2002: 256). In 2000, the EU was the world’s largest exporter of white sugar with 30 % of world exports, while Brazil and Thailand were second and third (Gibb 2004: 569). At the same time, the Producer Subsidy Equivalent (the farm gate sugar price comprised subsidy) in the EU was 43 %, while in Australia it was just 3 % (ibid.). According to King, Borell and Hubbard (2000), a liberalization of the EU sugar regime would make Australia, Brazil and Thailand the principal beneficiaries (ibid: 23). And in 2002, the three countries decided to challenge the EU sugar policy in the WTO.

6.2 The “WTO Sugar”-dispute

The dispute started On 27 September 2002, when Australia and Brazil requested consultations with the European Communities (EC) concerning the export subsidies provided by the EC in the framework of its Common Organization of the Market for the sugar sector (WTO DS265). Consultations were held in late November 2002, but had no result. In March 2003, Thailand requested consultations with the EC on the

same issue, consultations were held, but had no result. On 21 July 2003, Australia, Brazil and Thailand requested the establishment of a panel pursuant to Articles 4.7 and 6 of the DSU⁶ and Article XXIII: 2 of GATT 1994 and on 29 August 2003 a single panel for the three different disputes were established. The three different disputes were to be given a report each, at the request of the EC (Panel Report WT/DS265/R: 14-5).

At the core of the dispute were the production quotas of the EC sugar regime. There are two categories: A sugar and B sugar. These quotas constitute the maximum quantities eligible for domestic price support and direct export subsidies (called “refunds” by the EC). The quota system did not involve any limits on the quantities of sugar that may be produced or exported. The sugar in excess of A or B quotas were called C sugar, which did not receive support and had to be exported within a certain time. If not, a charge would be levied. In the panel report, it was mentioned that “the current (2002) EC sugar regime is scheduled for review in 2006” (ibid: 20-22). As a result of the EU being a relatively inefficient producer of sugar, and a sugar price three times higher than the world prices, export refunds are provided on surplus quota sugar exported from the EU. In order to profitably export sugar, EU farmers therefore need a substantial export subsidy (European Report 2002, Gibb 2004: 571).

A central Article in this case is Article 9.1 (a) and (c) of the Agreement on Agriculture in GATT 1994. This states that the following export subsidies are subject to reduction commitments:

- (a) the provision by governments or their agencies of direct subsidies, including payments-in-kind, to a firm, to an industry, to producers of an agricultural product, to a cooperative or other association of such producers, or to a marketing board, contingent on export performance;*
- (c) payments on the export of an agricultural product that are financed by virtue of governmental action, whether or not a charge on the public account is involved,*

⁶ Here meant to be understood as “The Understanding on Rules and Procedures Governing the Settlement of Disputes”.

including payments that are financed from the proceeds of a levy imposed on the agricultural product concerned or on an agricultural product from which the exported product is derived;(GATT 1994:50).

Compared to the GATT 1947 Article XVI: 1, this Article states that the member countries are committed to reduction of subsidies, not just to talk about the possibility of reducing them.

6.2.1 Arguments by the parties

Australia requested the panel to rule that the C sugar produced under the EC sugar regime was provided with an export subsidy and that this was a violation of article 9.1 (c) of the Agreement on Agriculture. If the panel did not agree with this, Australia wanted the panel to rule that the EC, by applying other export subsidies, violated Article 10.1 of the same agreement (Panel Report WT/DS265/R: 22). Australia also wanted the panel to find that the EC acted inconsistently with Article 3.1 of the SCM agreement because of a preferential import arrangement with India (ibid: 23). Australia requested the panel to recommend that the EC brought its export subsidies for sugar into conformity with its obligations under the Agreement on Agriculture and withdraw the export subsidies inconsistent with the SCM Agreement (ibid).

Brazil and Thailand had the same requests, but were even clearer in their wording by stating that they wanted the panel to recommend “that the EC bring its export subsidies for sugar into conformity with its obligations under the Agreement on Agriculture *by withdrawing without delay the export subsidies for sugar inconsistent with the Agreement on Agriculture*(Ibid:23).

The EC requested the Panel to find that, when referring to either Article 9.1 or 10.1, exports of C sugar were not in excess of the EC's reduction commitments and that by bringing this claim, the Complainants were acting inconsistently with the general principle of good faith and Article 3.10 of the DSU. The same applied to the suggested violation of the SCM agreement (ibid: 25).

6.2.2 Arguments by Third Parties

This case holds a substantial number of third parties, and several of the third parties are also economically powerful countries. The complete list is:

Australia; Barbados; Belize; Brazil; Canada; China; Colombia; Cuba; Fiji; Guyana; India; Jamaica; Kenya; Madagascar; Malawi; Mauritius; New Zealand; Paraguay; St. Kitts and Nevis; Swaziland; Tanzania; Thailand; Trinidad and Tobago; United States; Côte d'Ivoire

Among the third parties, seven are members of the “*Global Alliance for Sugar Trade Reform and Liberalization*” (GAS) which was formed in 1999 and called for a “WTO agreement on agriculture that includes positive, progressive, and meaningful reform of the world sugar market by ensuring that sugar is included as an important element of the agricultural trade agenda” (GAS 2009). The Alliance represents more than 50 percent of world sugar production and more than 85 percent of world raw sugar exports (ibid).

Canada noted that despite it being true that sugar production in the European Communities was the subject of a complex regulatory regime; this complexity was not by itself proof that C sugar benefited from export subsidies. They were also clear on that the Article 9.1 had to be read so as to maintain the distinction between domestic support and export subsidies (Panel Report WT/DS265/R: 94). The complainants in this case had principally based their argument on DS103/113 Canada - Dairy (ibid: 31). This dispute was about export subsidies on dairy products from Canada which ended in a ruling against Canada. Canada then appealed to the Appellate Body, which reversed some of the findings quite similar to the proceedings in the “WTO-Softwood lumber”-dispute. The DS103/113 dispute also ended with a mutually agreed solution between Canada, the U.S. and New Zealand (WTO DS113). The fact that Canada did not give its fellow members of the GAS an outright support can perhaps be found in their on interest in maintaining their agricultural policy and not contribute to a ruling in a WTO case that could be used against them.

China said that if C sugar were in fact subsidized, that this subsidy should be reduced (ibid: 95). India made statements that did not say much about the specific case, but rather said that WTO rules should be followed if violated (ibid: 100). The United States noted that it took no view as to whether, under the facts of this dispute, the measures at issue were consistent with the Agreement on Agriculture and/or the SCM Agreement. The relevant question for the United States was whether or not the EC did subsidize. If they were, then the EC need to bring its measures into compliance with WTO rules (ibid: 108-9). This action by the United States can be seen as a wish to increase the legitimacy of the WTO agreement and its rules. The United States here also uses the “hard” legalization of the WTO to press the EU to show the credibility of their commitment. That the United States did not take a stand on the consistency related to the specific agreements, can maybe come from the fact that they themselves has a sugar program designed to protect domestic producers (Irwin 2002:61, 143), and did not want to make a clear statement that could be used against them later.

6.2.3 Conclusions by the panel

On 15 October 2004, the Panel circulated to Members its separate but identical reports of the cases WT/DS283, WT/DS266 and WT/DS265. The Panel concluded

that the European Communities, through its sugar regime, has acted inconsistently with its obligations under Articles 3.3 and 8 of the Agreement on Agriculture, by providing export subsidies within the meaning of Article 9.1(a) and (c) of the Agreement on Agriculture in excess of its quantity commitment level specified in Section II, Part IV of its Schedule, which since the marketing year 2000/2001 is for 1,273,500 tonnes of sugar and (ii) its budgetary outlay commitment level specified in Section II, Part IV of its Schedule⁷, which since the marketing year 2000/2001 is €499.1 million per year (Panel Report WT/DS265/R: 178).

⁷ Schedule is documents about agricultural policies, specifying in quantitative detail the commitments (on allowable quantities of subsidized exports and outlays on export) the Countries has accepted under the Agreement on Agriculture (Tangermann 2002:259, 265).

The Panel decided to exercise judicial economy and declined examine the Complainant's export subsidy claims under Article 3 in the SCM agreement (Panel Report WT/DS265/R: 178). The term judicial economy describes the discretionary practice of a panel to abstain from making a finding on a claim presented by a complaining party, on the grounds that another finding (or findings) of inconsistency already sufficiently resolves the dispute at hand (Bohanes & Sennekamp 2006: 424).

The panel therefore recommended the Dispute Settlement Body to request the EC to bring its EC Council Regulation No. 1260/2001, as well as all other measures implementing or related to the European Communities' sugar regime, into conformity with its obligations in respect of export subsidies under the Agreement on Agriculture (Panel Report WT/DS265/R: 179). The Panel then suggested the EC to bring its production of sugar more into line with domestic consumption whilst fully respecting its international commitments with respect to imports, including its commitments to developing countries (*ibid*).

Brazilian Foreign Minister Celso Amorim said the decision was a big victory for Brazil's sugar producers, while a representative for OXFAM, an NGO who have been critical of the EC sugar regime for years, said that "this ruling is a triumph for developing countries and a death knell for unfair EU sugar export subsidies, which undermine poor farmers' livelihoods and deny them the chance to trade their way out of poverty" (SEQUERA 2004).

The EC then appealed the findings 13 January, and on 28 April 2005 the Appellate Body Report was circulated. The findings of the Panel Report were upheld, and made a clear statement, as opposed to the GATT report, that the EC "violations of the Agreement on Agriculture nullified or impaired the benefits accruing to the Complaining Parties under the Agreement on Agriculture" (WT/DS265/AB/R: 346). The Appellate Body did however find that the Panel erred in applying "judicial economy" in the SCM part of the case, but found itself not in a position, and declined to complete the legal analysis and to examine the Complaining Parties' claims under

the SCM Agreement left unaddressed by the panel⁸ (ibid.). 19 May 2005, the DSB adopted the Appellate Body report and the Panel report, as modified by the Appellate Body report.

6.3 Actions by the EC

In 2005, the EU exported over 5 million tons of sugar a year and spent around 1.3 billion Euros a year on export subsidies. The WTO Appellate Body ruled that the EU had to limit its subsidized exports of sugar to 1.273 million tons a year and reduce its annual expenditure on export subsidies to 499 million Euros a year (European Report 2005). In a statement to the verdict by the Appellate Body, EU Trade Commissioner Peter Mandelson said that "We will abide by our international obligations on the sugar regime and will work closely with member states on the necessary reforms ahead of the WTO Ministerial in December" (Xinhua News Agency 2005) Both Brazilian and Australian representatives were happy with the verdict. Brazil's WTO ambassador Luiz Felipe de Seixas Correa said the ruling, along with an earlier WTO ruling against US cotton subsidies initiated by Brazil, represented a "historic decision that is certainly going to help the inclusion of agriculture in the multilateral trading rules system" (Agra Europe 2005). He is supported by Jackson, who claims that these disputes "will undoubtedly have implications for the new Doha round of trade negotiations and for the agriculture subsidy practices of the United States, EU, Japan and Canada" (Jackson 2006: 163).

At the DSB meeting on 13 June 2005, the European Communities informed the DSB of its intention to implement the recommendations and rulings of the DSB, and stated that it would require a reasonable period of time to implement them (WTO DS265). The complaining parties were however not satisfied. Australia's WTO ambassador Spencer had already 29 April 2005 said that EU compliance with the WTO ruling would not require any legislative changes and that there was "no reason why they

⁸ Here we again see that the Appellate Body was not able, as in the "WTO-Softwood lumber"-dispute DS277, to complete the full analysis of the facts of the dispute.

can't do it (comply with the ruling) straight away" (Agra Europe 2005b). 9 August 2005, the complaining parties to the dispute informed the DSB that as the parties had been unable to reach agreement on a reasonable period of time for implementation in accordance with DSU Article 21.3(b), and that they would like to request that the reasonable period of time be determined through binding arbitration (WTO DS265). This was done, and 28 October 2005 the arbitrator determined the reasonable period of time to 12 months and 3 days, expiring on 22 May 2006 (ibid).

In September 2005, EU decided to declassify its sugar quotas, which resulted in almost 1.9 million tons of sugar and other sweeteners produced under the EU's A and B domestic production quotas to be declassified as C sugar, which can be sold on the international market at global prices. Australia, Brazil and Thailand argued that this would result in approximately 7.2 million tons of subsidized EU sugar exports in 2005, almost 6 million tons above the EU's allowed limit (Agra Europe 2005c). The three countries would however not pursue this as a new dispute under the WTO, but asked for the decision to be discussed at a WTO meeting in October 2005. They strongly cautioned the EU against taking measures such as sugar declassification which would serve to undermine both the EU's WTO obligations and the effective functioning of the Dispute Settlement Body (ibid.). An EU spokesman said the decision to de-classify the excess sugar was perfectly legal under WTO rules, since the trade body had yet to tell the EU from what point it had to come into compliance with the sugar panel's verdict (ibid).

On 8 June 2006, Australia, Brazil and Thailand informed the DSB that they each had reached an Understanding under Articles 21 and 22 of the DSU with the European Communities. This agreement states that the EC feels that they have complied and that the complaining parties are not satisfied with the compliance within a reasonable period of time. The agreement therefore states, *inter alia*, that 1) the complaining countries are entitled at any time to request the establishment of a panel pursuant to Article 21.5 of the DSU; 2) the European Communities shall accept the establishment of that panel 3) that time limits are to be followed; 4) the complaining parties shall not

request authorization to suspend concessions or other obligations under Article 22 of the DSU until the adoption by the DSB of the Article 21.5 panel report and, where relevant, the Appellate Body report; and 5) The parties to this dispute will continue to cooperate in all matters related to this Understanding and not to raise any procedural objection to any of the steps set out (WT/DS265/36). The agreement can be said to be an agreement between the countries on “how to continue to disagree.” One of the reasons for the disagreement was that Australia, Brazil and Thailand not only objected to the fact that C sugar export licenses would remain valid for use until the end of August, but also the fact that EU sugar exports in 2005/06 would increase with several tons (Agra Europe 2006).

Three weeks later, reform of the EU sugar regime was in place. This reform had been debated for some time, and as mentioned in the WTO Panel Report, a reform was already scheduled in 2002. In 2004, ten member countries, including among others Italy, Spain, Greece and Finland, warned of the “devastating effect” of the reform, while NGOs like OXFAM and WWF released papers supporting the reform (European Report 2004). In 2006, a consensus emerged. The result was that the EU institutional price for white sugar would be cut by 36% over four years from 2006 with a cumulative reduction over four years of 20%, 27.5%, 35% and 36%. The minimum price for beet would be decreased by 39.5% over the same period. All beet growers would receive an average of 64.2% for losses in earning because of the price cut. The A and B quotas would be merged into a single production quota. Validity of the new regime, including extension of the sugar quota system, was set to be until 2014/15. From 2009, the 49 poorest countries in the world were to have complete access to EUs market (Agra Europe 2005b, EU 2006). The European Commission, declared in a statement that the reform would “ensure a long-term sustainable future for sugar production in the EU, enhance the competitiveness and market-orientation of the sector and strengthen the EU's position in the current round of world trade talks” (Xinhua News Agency 2006).

In 2008, the Economist could tell us that “next year the EU should become a net importer of sugar for the first time” (Economist 2008). And there has not been a new dispute in the WTO between the countries involved in the WTO sugar case. This could signal that the countries in the dispute have been satisfied since its conclusion. At the same time, the Doha Round of trade negotiations, which was launched in 2001, has been stalled due to disagreements over farm subsidies and import tariffs (Xinhua News Agency 2008). This round has yet to be concluded, and the fact that multilateral trade talks are being held, could explain why a new case has not emerged. The verdicts in agricultural trade disputes in the WTO that Jackson (2006) and Steinberg (2005) believed would help favor agricultural subsidy reductions, have therefore not been proven to have such effect.

6.4 Comparing the GATT and the WTO disputes

The GATT disputes ended in virtually nothing, whereas the WTO disputes ended with a reform of the EU sugar regime. Where the panel reports from the GATT period did not have a clear statement about a violation and did not recommend anything, the panel reports from the WTO disputes made it very clear that the EC had violated the WTO rules and both the Panel and the Appellate Body recommended the EU to bring its policy into conformity with its obligations. The EU said it was willing to comply, but then the “WTO-Sugar”-dispute ended with an agreement between the parts that makes it clear that the complaining parties were not satisfied with the respondent’s compliance. This is in contrast to the “Japan-Alcohol”-dispute, where the complainants were satisfied. At the same time, a change in the EU sugar policy is clearly visible and they are now on their way to becoming a net importer of sugar. What can explain this change and did the legalization play a part in it?

In 2002, before the WTO disputes started, the EU sugar reform was already in the making. This was a reform of a system that was expensive, left sugar in excess on the world market, was in direct opposition to the economic rationality of free trade and received harsh criticism from NGOs working with third world development (Norberg

2003, Gibb 2004). In order to get the will to reform the system, the EU needed to go through internal political processes. According to Gibbons (1992), there have been especially three sources of pressure on the EU CAP system, which the sugar regime was a part of. These are 1) International pressure channeled through the Uruguay Round and GATT, 2) an internal momentum which has come from within the EU for financial reform, especially during the 1980s/early 1990s, and 3) the impact of issues from the wider EU agenda on the CAP, especially the Single European Market, changing consumer habits, enlargement of the EU and the environment (ibid.: 286). As the EU has evolved, its policies have undergone change and an internal debate. A growing world consensus towards the importance of free trade, a consensus the EU has had a part in creating, has continuously increased the external pressure for reform. As a curiosity, Peterson and Bomberg (1999) claims that external pressure to reform the CAP sometimes actually has stiffened European resolve to defend the existing CAP (ibid.: 121). Nevertheless, in 1999, a reform of the CAP was made based on the need to adapt to the EU's WTO commitments, current and future, and the need to prepare for Eastern enlargement (Tangemann 2002: 276). The reasons given by the EU for the sugar regime reform was first and foremost to strengthen the EU market position.

This also makes the time aspect relevant. The EU sugar regime had been unchanged since 1968. The actions taken by the EU can therefore be seen as a natural reform based on the need to adapt to a changing international environment. Their sugar policy had been criticized since the late 1970s, it had been challenged under two GATT disputes and it was also a part of the heated argument over agriculture under the Uruguay Round. A change is therefore not surprising, and if anything, the WTO verdict can have made it easier for the supporters of the reform to prove its necessity. The EU can also use the WTO verdict to give them both a better international reputation and better credibility, by claiming that the reform show that they are willing to change according to the demands of the WTO. This supports both the neoliberal notion that legalization can be used to press domestic actors to change, and the realist notion that state representatives only use the language of international law

as a rhetorical device to justify their behaviour, which is in actual fact only motivated by the desire to serve their national interest.

When discussing the possibility of using international organizations as “tools” for change in agricultural policy, Hudec (1998, in Tangermann 2002: 254-55) states that “If governments lack the political will to obey the rules, the rules will not work, no matter how well they are crafted” (ibid.) He then further claims that

In agriculture, there was “a lack of political will on the part of the relevant governments. However much they may have declared their desire to liberalize agricultural trade, the large developed countries of North America and Europe that yielded ultimate power in GATT did not really want to liberalize agricultural trade. Each of these governments was committed to a program for supporting farm income.” (ibid.).

Hudec then concludes on the new Agreement on Agriculture (AoA) that

although the (...) rules of the AoA are likely to have few if any immediate liberalizing effects, it can be said that the basic design does set the WTO in the right direction (...) the Export subsidy commitments in the AoA do avoid the major weaknesses of their antecedent GATT provisions (ibid.).

These facts are important when analyzing the actions taken by the EU. The WTO DSS together with the new AoA made the “WTO-Sugar”-dispute end with a clear ruling based on the new agreement, as opposed to the “GATT-Sugar”-dispute, where the result were an unclear ruling due to an unclear law. This is in line with the neoliberal principles for “hard” legalization outlined in chapter 3. But if legalization played a part in changing the EU policy, it was due to the increased precision of the individual commitments accepted by the countries in the AoA. The legalized dispute settlement procedures played a minor role, and can in fact be said to have given the EU, due to the possibility of appealing, “room to breathe” and at the same time provide an opportunity to continue with its exports subsidy while finishing the political bargaining for a sugar reform. The WTO dispute took three years more to complete

than the GATT dispute, and the EU is still subsidizing sugar. The WTO verdict thus provides legitimacy to the export subsidy provisions of the AoA, an instrument that Tangermann (2002) points out is “a trade policy instrument that should not, according to GATT principles, exist at all” (ibid.: 265). The increased legalization, although it did not provide a substantial change the EU sugar policy, did at least provide a clear verdict as opposed to the GATT dispute. This can have an effect at the completion of the Doha Round, but this remains to be seen.

The vague “equitable share” in the GATT has been replaced by “the precise quantitative limits by country and product group, with corresponding notification requirements and the transparency they create in the WTO committee on Agriculture” (Tangermann 2002: 265). The verdict can therefore be said to be not as much a result of the procedure as it is a result of the new agreement. Tangermann (2002) claims that “it is probably not wrong to say that the reduction commitments on ‘old’ export subsidies” in the AoA are targeted at the EU, since EU holds a share of more than 85 % of all the worldwide export subsidy expenditure (ibid: 266). And even though the AoA is targeted at the EU, the EU did, in the period 1995 to 1998, grant less than 50 % of the export subsidies it could have spent in accordance with its commitments (ibid:275). The WTO verdict together with the AoA thereby provides legitimacy to the export subsidy provisions of the AoA, an instrument that is “a trade policy instrument that should not, according to GATT principles, exist at all” (ibid.: 265). These facts also supports the views held by the enforcement school, which claims that countries will enter into agreements that require little change in policy.

The change in behavior on the EU part in this case is in my opinion more a result of the time aspect mentioned above. The legalization made the EU follow the proceedings, but they also did this under GATT. And when the WTO verdict provided a clear statement, the only result of this was cosmetic changes in the sugar regime. The real change, the sugar reform, comes from other sources than the legalization.

Zangl (2008) investigates two disputes where agricultural products are the issue, “the citrus/bananas case”, where the EU was the respondent and the United States was the

complainant. Where the GATT citrus case took ten years and ended with an agreement, the WTO bananas case took four years, ended with a verdict against the EU, and then took another two years for the parts to conclude on a WTO compliant regime on bananas (ibid.: 844) Zangl then claims that “one can maintain that it (the EU) is more compliant under the judicialized WTO procedure than it had been under the diplomatic GATT mechanisms” (ibid.). In “the citrus/bananas case” the opponent was the United States, the most powerful nation in the world. In the “WTO-sugar”-dispute, which also centers on agricultural policies, the opponents were smaller countries, and this changed the power distribution in favor of the EU. I would say that if these procedures had an effect, it was relatively small compared to the effect of the new Agreement on Agriculture, internal discussion, the need to reform an old sugar regime and to adapt itself to the rules of a new organization. As opposed to what Zangl (ibid.) found in his article, in the “EC-Sugar”-dispute, the EU is not more compliant with the WTO procedure than with the GATT mechanisms. It does however support the statement made by Zangl that the effect of the legalization “might well be limited to disputes among roughly equally powerful actors such as the United States and the EU” (ibid: 847).

When faced with a powerful opponent under the GATT regime, namely the United States, the EU decided to block the formation of a panel for a year and then the adoption of the panel report (ibid:842). In the “GATT-sugar”-dispute, faced with weaker opponents, they did not block any part of the process. When they were ruled against, they did not change their policy. Clearly, a dispute against a weaker opponent under the GATT was not something that concerned the EU and could provide a reason to why the EU behaved differently in the sugar dispute than in the “citrus/bananas dispute”.

The EU was one of the parts that pressed for legalization during the Uruguay Round, and by using the Appellate Body in this case, they could postpone a verdict while keeping their export subsidies intact. In the area of agriculture, free trade has a long way to go, and by creating this legitimacy of export subsidy, an instrument EU is the

biggest user of and where it also has the opportunity to use it on a larger scale, the verdict against the EU can actually serve its interest and give increased legitimacy to a reform they already had planned.

7.0 Main findings and discussion

Compliance is “a state of conformity or identity between an actor’s behavior and a specified rule”. Closely linked to this is implementation, the process of putting international commitments into practice. In this chapter I will discuss the effect the WTO DSS had on compliance in the three pairs of cases I have investigated. I will do this in light of the theories outlined in chapter three.

7.1 The “Japan Alcohol”-dispute

The “Japan Alcohol”-dispute pair is the clearest case of an increased effect on compliance due to legalization. The case was tried under both the GATT DSS and the WTO DSS, and where the GATT made Japan change their policies somewhat, the WTO made them comply to full, and with the satisfaction of the complainants. However, both the realist explanation and the enforcement school explanation have to be considered in this case pair.

In the GATT dispute, Japan was faced with the European Communities. The United States and Canada did support the EC, but did not make it into a case of their own. In the dispute under the WTO, Japan faced actual complaints from all three countries, which together with Japan have the highest share of world trade. The distribution of power was now more in favor of the complainants, thereby increasing the pressure on Japan. The outcome of this dispute can therefore plausibly be linked to the realist explanation.

This dispute does also contain support for the views held by the enforcement school. There are several indications pointing to the fact that Japan must have expected that their alcohol policy were going to be disputed under the new WTO DSS: Japan had actively contributed in the Uruguay Round leading to the creation of the WTO. They had also supported the establishment of a legalized dispute settlement system. In addition, prior to the creation of the WTO, Japan participated in trade talks were their

alcohol politics were being heavily debated and criticized by the later complaining parties in the WTO case. These facts could suggest that Japan entered the WTO knowing that their alcohol policy was going to be tested under a trade regime with clearer rules and time limits and with stricter implementation demands, thereby increasing the international pressure for alcohol tax reform. This could suggest support for the enforcement claim that countries enter agreements with an already established knowledge of what the cost will be. But understand why then Japan spent time on debating their alcohol policy during the Uruguay Round and at the same time pressed for legalization, it is necessary to look at the domestic level.

The institutionalist claim that legalization can increase the ability to commit domestic actors with diverging views to an international commitment is highlighted with this dispute pair. Several studies have shown that the voting system in Japan has favored the representation of producer groups who feel threatened by trade, thereby exacerbating Japan's conflict with the United States (Gourevitch 2002: 312). Pekkanen (2001) claims that after winning disputes under the GATT, the Japanese attitude towards international trade rules changed in the late 1980's (ibid: 58). Bureaucrats in the Japanese state saw this as an opportunity "to counteract protectionist interest in politically powerful sectors" (ibid: 41). In the alcohol dispute under the WTO, bureaucrats from the Japanese Ministry of Finance "were able to play on the importance of upholding Japan's legal obligations in a multilateral setting and, even more importantly, of the material risks that could be inflicted under the WTO rules" (ibid: 66). Also, for a country of Japan's power and size, being compliant with an international ruling, can be in their interest. Their compliance can contribute to increase the legitimacy and credibility of the WTO and the legalized system, which for Japan can be useful when they are the complainant, especially in disputes against more powerful parties as the U.S and the EU.

In my opinion, the "Japan Alcohol"-dispute is an example of all the mechanisms outlined by the Neoliberal Institutionalists working together to secure compliance with the rulings of an international organization. The legalization increased the

pressure for alcohol tax reform in Japan both on the international and domestic level. As mentioned in chapter 3, NLI does not ignore the effect of state power on other states, which is present in this case. But this still doesn't make the design of an organization irrelevant, as this case show.

7.2 The “EU Sugar”-dispute

The “EU Sugar” dispute pair is a more complex matter than the “Japan Alcohol”-case pair. The WTO dispute lead to a change in the EU policy concerning sugar after a dispute where the complainants Australia, Brazil and Thailand were up against a more powerful adversary. The EU seems to have been more compliant with the rules and rulings in the WTO dispute than in the GATT dispute. What were the mechanisms leading to this, and when looking at implementation and actual change in the EU sugar policy, did the EU really comply?

One of the arguments for legalization set forward by institutionalists, is that legalization entails a specific form of discourse, requiring justification and persuasion in terms of applicable rules and pertinent facts, which largely disqualifies arguments based solely on interests and preferences. Compared to the old GATT agreement the WTO Agreement on Agriculture (AoA) is a lot clearer on rules concerning agriculture and these rules are also expressed in numerical commitments (Tangermann 2002: 257). The EU did not block any part of the process in the GATT dispute, but then again, the GATT rules for agriculture were not clear and made a ruling in the GATT dispute virtually toothless. When a similar dispute appeared before the WTO system, considerations based on numbers and facts were much easier to make, and the case ended in a clear recommendation by the Dispute Settlement Body. The increased precision WTO as a whole thus increased the possibility of this dispute reaching a solution, and a solution that was based on factual aspect

However, the views held by the enforcement school are also highly relevant in this case. Before the WTO case started in 2002, the EU was planning a reform of its sugar regime, which had been more or less unchanged since 1968. And since the creation of

the WTO in 1995 the EU had been exceeding its annual commitment levels concerning sugar exports (WTO DS265). The reasons given for the reform was based on securing the competitiveness of EU sugar production for the future. Thus, by entering an organization (the WTO) and then later complying with WTO rulings, the EU achieved a practically “cost free” increase in the credibility of their commitments. And by stalling both the adoption of the panel report by appealing to the Appellate Body and then the implementation, the legalization of the WTO gave them a period of “cost free” non-compliance as mentioned by Horlick (2002). The term “cost-free” could even be seen as an understatement due to the fact of the possible gains the EU had by being able to keep their policy for a longer period of time. The entire negotiation period of the new sugar reform was by this being held with their policies intact. This dispute do however suggest that a state’s (or union of states as the EU) preferences can be changed due to participation in an international agreement. The CAP reforms, including the sugar reform, made by the EU have all come about partially due to participation in both trade talks such as the Uruguay Round and trade organizations such as the GATT/WTO. But if the increased legalization made this happen, is not strongly supported. The long diplomatic Uruguay Round made a clearer contribution.

At the same time, the legalization of the WTO could have contributed to strengthening the arguments for those countries pressing for reform in the internal EU discussion. This is in line with the NLI hypothesis of legalization being able to commit domestic actors, in this case other countries in the internal EU discussion, with diverging views to an international commitment. Looking upon the history of supporters and opponents of agricultural trade liberalization in the EU, Britain has been the strongest supporter and France the strongest opponent. Already in 2000, The UK agricultural minister welcomed the prospect of reform of the EU sugar regime (M2 Presswire 2000). One of the reasons for the length of the Uruguay Round was EU, and particularly French, opposition to agriculture reform (Economist 1993, Ostry 2002: 285). But the potential gains from service sector liberalization led France and other European states to agree on a negotiation agenda that included trade (Davis

2004: 156). The result of the Uruguay Round was as we now know a new trade agreement with legalized rules. That the new legalized system and the loss in the dispute can have had an effect on making the new sugar reform happen, because of the increased ability to press domestic actors provided by the legalization.

However, on the international level the “EC Sugar” dispute it is hard to see that the EU has complied. Compared to the “Japan Alcohol”-dispute, which ended with the satisfaction of the complainants, the “EC Sugar”-dispute ended with an agreement where the complainants were not satisfied. That the complainants were not satisfied is however not enough to establish clear non-compliance on the EU part. In the “EC Sugar”-dispute, the complainants would have had substantial benefits if the world sugar market would be completely liberalized. To claim dissatisfaction is in the complainants interest and could be used by the complainants at the Doha Round. So an agreement that states that the EC feels that they have complied and that the complaining parties are not satisfied with the compliance within a reasonable period of time is about the same outcome as under the GATT: A diplomatic stand off. The precise sugar quotas in the WTO Agreement on Agriculture were violated by the EU for over ten years. Compared to the GATT rules on agriculture, a violation of the WTO Agreement on Agriculture is easier to see. But to prevent it and stop it, is still hard.

7.3 The “US lumber”-dispute

Zangl claims that “the EU is the only contender with whom the United States had disputes that allowed pair wise comparisons of similar cases”(ibid: 832). The “US lumber”-dispute pair shows that this is wrong. It also contradicts the claims made by Zangl, because it ended in the same way under both the GATT and the WTO. Upon the creation of the WTO, the signing countries “saw increased legalization of the judicial process as a means of constraining U.S. unilateralism (that is, action pursuant to section 301) by effectively forcing the United States to seek decisions from the DSB before imposing sanctions for alleged noncompliance with WTO

obligations”(Steinberg 2004: 250). This dispute show that this was not achieved, and the United States did not change their behavior, at least not in this dispute pair.

The case leads to the problem pointed out by Kim (2008):

Legalization (...) imposes costs on countries by increasing the complexity and difficulty of procedures for them to utilize. Countries with the bureaucratic and administrative capacity to follow the elaborate procedures reap the benefits of increased legalization (...) legalization of international institutions does not level the power-based playing field of international politics (ibid: 658)

Kim’s study concludes that developed countries are more likely to utilize dispute settlement. The “US lumber”-dispute pair shows that although Canada was willing to take the dispute to the WTO six times, the economic cost of keeping the trade dispute going and the persistence of the United States to not yield, in a legalized system with disputes between developed countries, the power based playing field is still not leveled. Also, the “irresistible temptation” to delay compliance described by Horlick (2002) is highly relevant in this dispute. Under the GATT, although the opportunity for member countries to block each step of the process was possible, the opportunity to delay compliance “legally” through the Appellate Body was not available. Under the GATT, after bilateral consultations, the lumber dispute in 1987 ended quickly in a brokered settlement. The second “GATT Lumber”-dispute from 1991 to 1993 took one year more, but ended with another agreement.

With the WTO, the United States could delay both compliance and signing a possible deal because of the legalized system. At the same time, they could continue to collect funds from the countervailing duties imposed on Canada, thereby continuously increasing the sum of money to be used as a tool for getting Canada to the negotiation table. So the end result was that the legalized dispute settlement system, established very much as an interest of the most powerful nation in the world helped the same nation, by being able to prolong the dispute period, to increase leverage in a future negotiation. This is in keeping with the realist view that the institutions of the world

mirror the interests of powerful states. Also, it is in keeping with the realist notion that states seek to increase their power in the international anarchy.

From a strictly economic point of view, an importing country can benefit from receiving subsidized goods. Even when a subsidy harms domestic producers, it allows the importing country to purchase imports at a lower price, “thanks to the generosity of foreign taxpayers” (Irwin 2002: 112). But subsidies also generate political friction among trading partners, each viewing the other’s government as putting a finger on the scales of international competition to tip the outcome toward its own favored producers (ibid). The relative gains view held by realists could be used as an explanation for the anti-free trade stance taken by the United States in this dispute, even when it was faced with goods subsidized with another country’s money. This dispute ended in cooperation via an agreement, but from an economic point of view, the agreement is the best outcome for neither the United States nor Canada. This dispute pair is in keeping with realists claiming that states often fail to cooperate even in the face of common interest.

The CVD used by the United States in this case is based on Section 301⁹ of the Trade Act of 1974. Section 301 deals with two practices: (1) violations of U.S. rights under a trade agreement, and (2) otherwise unjustifiable, unreasonable, or discriminatory actions or policies that burden or restrict U.S. commerce (Finger 1991: 132). This is a unilateral approach to addressing trade disputes, and was not viewed favorably by the rest of the world. When negotiating the new WTO dispute settlement procedures, the United States, “aligned closely with Canada” (Barton et al 2006: 70) proposed both the automatic adoption of panel reports and the right to appeal to a new Appellate Body. The time limits would be modeled after the time limits in the Section 301. The U.S. view was that if WTO rules were in consistence with the timelines in Section 301, a more legalized WTO dispute settlement system would legitimize U.S. use of its market power to pressure other countries to comply with U.S trade policy objectives

⁹ Although it says section 304 in the panel report, to say section 301 is correct. The entire section consists of section 301 - 310. See WTO DS152, report of the panel.

(ibid: 71). The result was that the Dispute settlement Understanding works in almost complete sync with section 301 to create political incentives for foreign governments to comply with their WTO obligations and to restrain U.S unilateralism when foreign governments are complying. Therefore, “from the U.S. government perspective, the radical judicial reforms of the Uruguay round represented (...) an Americanization of the GATT/WTO dispute settlement process (ibid:74).

The problem with the Section 301 is that it unchains the U.S. export interests from the necessity to oppose U.S. import competing interests. It arms the U.S negotiator not with the authority to *remove* U.S import restrictions, but with the *threat* to impose new ones and thus providing the domestic political mechanisms to press for export expansion without paying the price of removing U.S. import restrictions (Finger 1991: 132).

The politics of the Section 301 was challenged by the EU in the WTO dispute DS152 from 1998, but the Section 301 was found not to be inconsistent with the WTO rules. Canada supported the EU view as a third party (WT/DS152/R: 236). The United States has with the establishment of the WTO both managed to give its domestic policy increased international legitimacy and increased their possibility for power use. The “US lumber”-dispute supports a realist world view from start to finish, and contrary to what Zangl found in his article, I found that the United States did not change their behaviour due to legalized dispute settlement.

In all three dispute pairs in this thesis, the possibility to block a part of the GATT process has not been used extensively. The only time was at the beginning of the “GATT Alcohol”-dispute. The countries in question were all willing to follow the GATT procedures when a complaint was made. However, all the WTO disputes in this thesis have been appealed to the appellate body which, in the cases where the EU and the United States were the respondent, proved to serve the interest of the more powerful part in the dispute. This was also the parties that pressed for the legalization of the WTO. To block a part of a process in an international organization can decrease

both the credibility of a country's commitment to an agreement and its reputation as a cooperative country.

As opposed to this, to appeal a verdict under a legalized regime is easier to defend and at the same time shows that a country is willing to follow the procedures of an international organization. Appealing is thus a more legitimate way of postponing a decision while keeping your policies intact. For a rational self interested actor, this opportunity is something it won't miss. More rules, more procedures and more numbers also make an appeal more likely; there is more to disagree upon. And when the judges you face don't have the resources to investigate all the aspects of a dispute, non-compliance can be defended.

In the dispute pairs I have investigated, the GATT disputes lasted shorter than the WTO disputes. With the exception of the "JAPAN-Alcohol"- case, the outcomes in the WTO disputes were more or less the same as under the GATT: Although a violation was proven, full compliance were not chosen and a deal were made. And the more powerful the actor was, the more did the legalized procedures serve its interest. Interestingly, these were the same actors who wanted it.

8.0 Conclusion

8.1 Summary

In this thesis I have investigated the effect the new legalized dispute settlement system introduced by the WTO in 1995 has had on compliance. A major objective has been to check the robustness of findings reported by Zangl (2008). Zangl claims to have found a change in countries behavior due to increased legalization. I have tested whether his findings extend to a different set of cases.

In chapter 2 I explained how the GATT DSS worked, and described how the WTO brought about a more legalized DSS compared to the GATT.

In chapter 3 I used two different theoretical schools within political science, realism and neoliberal institutionalism, to develop a set of hypotheses about the expected effects the change from a more diplomatic system to a more legalized system might have. While realists expect such a change to have little or no impact on a nation's behaviour, neoliberal institutionalists claim that the design of an institution will often impact on cooperation and compliance.

In chapter 4, 5, and 6 I analysed three pairs of similar disputes, each pair consisting of one dispute that was tried under the GATT DSS and one that were tried under the WTO DSS. The pairs I chose included (1) two disputes over alcohol taxes between Japan on the one hand and the EU, Canada and the United States on the other, (2) two disputes over lumber tariffs between the United States and Canada, (3) two disputes over sugar subsidies between the EU on the one hand and Australia, Brazil and Thailand on the other.

Finally, in chapter 7 I discussed the findings in light of the theories outlined in chapter 3.

8.2 Main conclusions

The most important conclusions entailed by the analysis in the preceding chapters may be summarized in six points

First, the dispute pairs I have analysed shows that power and state sovereignty remain significant factors in trade negotiations. The claim set forward by Hudec (1998, in Tangemann 2002: 254) that “if governments lack the political will to obey the rules, the rules will not work, no matter how well they are crafted”(ibid.) is still valid. The “US-softwood lumber”-clearly illustrate this. However, the “EU-sugar” dispute point in the same direction

Second, my analysis supports the institutional notion that international organisations can impact on countries behaviour, and that clearer rules and regulations, can make countries more willing to cooperate. Although power still plays a significant part in negotiations between countries, in both the “Japan-Alcohol”-dispute pair and in the “EU-sugar”-dispute pair, the new WTO rules seem to have enhanced cooperation

Third, my analysis suggests that when studying the effect international organisations have on compliance, the intentions towards a future trade policy held by the countries prior to a dispute is of importance. In both the “Japan-Alcohol”-case pair and the “EU-sugar”-case pair, pre-existing intentions of policy change played an important role in fostering cooperation and reform. This is in keeping with the enforcement school’s claim that compliance can come from an already planned intention of change.

Fourth, legalization can be used as a tool for convincing domestic actors that policy change is required. This is in keeping with the neoliberal school. The “Japan-Alcohol”-dispute pair is the strongest example of this effect, but the “EU-Sugar”-dispute pair reveals a similar tendency.

Fifth, and paradoxically, legalization can further increase the power of an already powerful country, as shown in the “US-Softwood lumber”-dispute pair. The

possibility to appeal a Panel Report to the Appellate Body represents an opportunity for countries to delay the adoption of a report. In the “US-Softwood lumber”-dispute pair, the fact that the United States could collect duties during the entire period of the dispute, which were lengthened by the appeal process, made their negotiation power even stronger than it would have been otherwise. Also, the “EU-Sugar”- dispute pair revealed that the appeal function might serve to lengthen a period with a trade policy not in conformity with WTO rules.

Finally, the US-Softwood lumber-dispute pair showed that the hope that legalization would prevent U.S. unilateralism was unwarranted (at least in this case). The United States is still willing to use the Trade Act of 1974 when its interests are threatened. This suggests that Zangl’s (2008) conclusions about a change in the trade related U.S. behaviour due to legalization must be modified.

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